PRUDENTIAL FINANCIAL INC
Form 10-Q
May 07, 2010
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# 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 March 31, 2010**

**OR**

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

**For the Transition Period from to**

**Commission File Number 001-16707**

# Prudential Financial, Inc.

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

| **New Jersey** | **22-3703799** |
|---|---|
| **(State or Other Jurisdiction of Incorporation or Organization)** | **(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   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 April 30, 2010, 464 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 external financing for our operations, which has been affected by the stress experienced by the global financial markets; (3) interest rate fluctuations; (4) reestimates of our reserves for future policy benefits and claims; (5) differences between actual experience regarding mortality, morbidity, persistency, surrender experience, interest rates or market returns and the assumptions we use in pricing our products, establishing liabilities and reserves or for other purposes; (6) changes in our assumptions related to deferred policy acquisition costs, valuation of business acquired or goodwill; (7) changes in our claims-paying or credit ratings; (8) investment losses, defaults and counterparty non-performance; (9) competition in our product lines and for personnel; (10) changes in tax law; (11) economic, political, currency and other risks relating to our international operations; (12) fluctuations in foreign currency exchange rates and foreign securities markets; (13) regulatory or legislative changes, including government actions in response to the stress experienced by the global financial markets; (14) adverse determinations in litigation or regulatory matters and our exposure to contingent liabilities, including in connection with our divestiture or winding down of businesses; (15) 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; (16) ineffectiveness of risk management policies and procedures in identifying, monitoring and managing risks; (17) effects of acquisitions, divestitures and restructurings, including possible difficulties in integrating and realizing the projected results of acquisitions; (18) changes in statutory or U.S. GAAP accounting principles, practices or policies; (19) changes in assumptions for retirement expense; (20) 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 (21) risks due to the lack of legal separation between our Financial Services Businesses and our Closed Block Business. The foregoing risks are even more pronounced in severe adverse market and economic conditions such as those that began in the second half of 2007 and continued into 2009. 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, 2009 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**

**March 31, 2010 and December 31, 2009 (in millions, except share amounts)**

| | March 31, 2010 | December 31, 2009 |
|---|---|---|
| **ASSETS** | | |
| Fixed maturities, available for sale, at fair value (amortized cost: 2010 $177,397; 2009 $174,251)(1) | $ 180,450 | $ 175,225 |
| Fixed maturities, held to maturity, at amortized cost (fair value: 2010 $5,081; 2009 $5,197)(1) | 5,016 | 5,120 |
| Trading account assets supporting insurance liabilities, at fair value(1) | 16,683 | 16,020 |
| Other trading account assets, at fair value | 3,371 | 3,033 |
| Equity securities, available for sale, at fair value (cost: 2010 $6,082; 2009 $6,106) | 7,088 | 6,895 |
| Commercial mortgage and other loans (includes $359 and $479 measured at fair value under the fair value option at March 31, 2010 and December 31, 2009, respectively)(1) | 30,760 | 31,384 |
| Policy loans | 10,223 | 10,146 |
| Other long-term investments(1) | 5,960 | 5,904 |
| Short-term investments | 6,924 | 6,825 |
| Total investments | 266,475 | 260,552 |
| Cash and cash equivalents(1) | 9,626 | 13,164 |
| Accrued investment income(1) | 2,368 | 2,322 |
| Deferred policy acquisition costs | 14,718 | 14,578 |
| Other assets(1) | 16,053 | 15,513 |
| Separate account assets(1) | 182,621 | 174,074 |
| **Total Assets** | $ 491,861 | $ 480,203 |
| **LIABILITIES AND EQUITY** | | |
| **LIABILITIES** | | |
| Future policy benefits | $ 125,743 | $ 125,707 |
| Policyholders account balances | 101,651 | 101,666 |
| Policyholders dividends | 1,787 | 1,254 |
| Securities sold under agreements to repurchase | 6,111 | 6,033 |
| Cash collateral for loaned securities | 3,180 | 3,163 |
| Income taxes | 4,059 | 4,014 |
| Short-term debt | 3,066 | 3,122 |
| Long-term debt (includes $0 and $429 measured at fair value under the fair option at March 31, 2010 and December 31, 2009, respectively)(1) | 21,641 | 21,037 |
| Other liabilities | 14,496 | 14,404 |
| Separate account liabilities(1) | 182,621 | 174,074 |

| | | |
|---|---|---|
| Total liabilities | 464,355 | 454,474 |
| **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; 641,762,125 and 641,762,089 shares issued at March 31, 2010 and December 31, 2009, respectively) | 6 | 6 |
| Class B Stock ($.01 par value; 10,000,000 shares authorized; 2,000,000 shares issued and outstanding at March 31, 2010 and December 31, 2009, respectively) | 0 | 0 |
| Additional paid-in capital | 23,186 | 23,235 |
| Common Stock held in treasury, at cost (178,150,917 and 179,650,931 shares at March 31, 2010 and December 31, 2009, respectively) | (11,290) | (11,390) |
| Accumulated other comprehensive income (loss) | 620 | (443) |
| Retained earnings | 14,478 | 13,787 |
| Total Prudential Financial, Inc. equity | 27,000 | 25,195 |
| Noncontrolling interests | 506 | 534 |
| Total equity | 27,506 | 25,729 |
| **TOTAL LIABILITIES AND EQUITY** | $ 491,861 | $ 480,203 |

(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 Months Ended March 31, 2010 and 2009 (in millions, except per share amounts)**

| | Three Months Ended March 31, | |
|---|---|---|
| | **2010** | **2009** |
| **REVENUES** | | |
| Premiums | $ 4,242 | $ 4,034 |
| Policy charges and fee income | 816 | 726 |
| Net investment income | 2,874 | 2,849 |
| Asset management fees and other income | 971 | 778 |
| Realized investment gains (losses), net: | | |
| Other-than-temporary impairments on fixed maturity securities | (1,249) | (1,855) |
| Other-than-temporary impairments on fixed maturity securities transferred to Other Comprehensive Income | 995 | 1,250 |
| Other realized investment gains (losses), net | 643 | 743 |
| Total realized investment gains (losses), net | 389 | 138 |
| Total revenues | 9,292 | 8,525 |
| **BENEFITS AND EXPENSES** | | |
| Policyholders benefits | 4,243 | 4,341 |
| Interest credited to policyholders account balances | 1,235 | 1,169 |
| Dividends to policyholders | 517 | (1) |
| General and administrative expenses | 2,281 | 3,013 |
| Total benefits and expenses | 8,276 | 8,522 |
| **INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES** | 1,016 | 3 |
| Income tax expense (benefit) | 353 | (2) |
| **INCOME FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES** | 663 | 5 |
| Equity in earnings of operating joint ventures, net of taxes | 10 | (6) |
| **INCOME (LOSS) FROM CONTINUING OPERATIONS** | 673 | (1) |
| Income (loss) from discontinued operations, net of taxes | (2) | 4 |
| **NET INCOME** | 671 | 3 |
| Less: Loss attributable to noncontrolling interests | (26) | (11) |
| **NET INCOME ATTRIBUTABLE TO PRUDENTIAL FINANCIAL, INC.** | $ 697 | $ 14 |
| **EARNINGS PER SHARE (See Note 8)** | | |
| **Financial Services Businesses** | | |
| **Basic:** | | |

| | | |
|---|---|---|
| Income from continuing operations attributable to Prudential Financial, Inc. per share of Common Stock | $ 1.17 | $ 0.00 |
| Income (loss) from discontinued operations, net of taxes | (0.01) | 0.01 |
| Net income attributable to Prudential Financial, Inc. per share of Common Stock | $ 1.16 | $ 0.01 |
| **Diluted:** | | |
| Income from continuing operations attributable to Prudential Financial, Inc. per share of Common Stock | $ 1.16 | $ 0.00 |
| Income (loss) from discontinued operations, net of taxes | (0.01) | 0.01 |
| Net income attributable to Prudential Financial, Inc. per share of Common Stock | $ 1.15 | $ 0.01 |
| **Closed Block Business** | | |
| **Basic and Diluted:** | | |
| Income from continuing operations attributable to Prudential Financial, Inc. per share of Class B Stock | $ 75.50 | $ 4.00 |
| Income from discontinued operations, net of taxes | 0.00 | 0.00 |
| Net income attributable to Prudential Financial, Inc. per share of Class B Stock | $ 75.50 | $ 4.00 |

*See Notes to Unaudited Interim Consolidated Financial Statements*

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**PRUDENTIAL FINANCIAL, INC.**

**Unaudited Interim Consolidated Statements of Equity(1)**

**Three Months Ended March 31, 2010 and 2009 (in millions)**

| | Prudential Financial, Inc. Equity | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Common Stock | Additional Paid-in Capital | Retained Earnings | Common Stock Held In Treasury | Accumulated Other Comprehensive Income (loss) | Total Prudential Financial, Inc. Equity | Noncontrolling Interests | Total Equity |
| **Balance December 31, 2009** | $ 6 | $ 23,235 | $ 13,787 | $ (11,390) | $ (443) | $ 25,195 | $ 534 | $ 25,729 |
| Contributions from noncontrolling interests | | | | | | | 3 | 3 |
| Distributions to noncontrolling interests | | | | | | | (4) | (4) |
| Consolidations/deconsolidations of noncontrolling interests | | (2) | | | | (2) | (1) | (3) |
| Stock-based compensation programs | | (47) | (6) | 100 | | 47 | | 47 |
| Comprehensive income: | | | | | | | | |
| Net income | | | 697 | | | 697 | (26) | 671 |
| Other comprehensive income (loss), net of tax | | | | | 1,063 | 1,063 | 0 | 1,063 |
| Total comprehensive income (loss) | | | | | | 1,760 | (26) | 1,734 |
| **Balance, March 31, 2010** | $ 6 | $ 23,186 | $ 14,478 | $ (11,290) | $ 620 | $ 27,000 | $ 506 | $ 27,506 |

| | Prudential Financial, Inc. Equity | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Common Stock | Additional Paid-in Capital | Retained Earnings | Common Stock Held In Treasury | Accumulated Other Comprehensive Income (loss) | Total Prudential Financial, Inc. Equity | Noncontrolling Interests | Total Equity |
| **Balance, December 31, 2008** | $ 6 | $ 22,001 | $ 10,426 | $ (11,655) | $ (7,343) | $ 13,435 | $ 351 | $ 13,786 |
| Contributions from noncontrolling interests | | | | | | | 276 | 276 |
| Stock-based compensation programs | | (74) | (9) | 110 | | 27 | | 27 |
| Impact of adoption of guidance for other-than-temporary impairments of debt securities, net of taxes | | | 686 | | (686) | 0 | | 0 |
| Comprehensive income: | | | | | | | | |
| Net income | | | 14 | | | 14 | (11) | 3 |
| Other comprehensive income (loss), net of tax | | | | | (546) | (546) | (40) | (586) |
| Total comprehensive loss | | | | | | (532) | (51) | (583) |
| **Balance, March 31, 2009** | $ 6 | $ 21,927 | $ 11,117 | $ (11,545) | $ (8,575) | $ 12,930 | $ 576 | $ 13,506 |

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

*See Notes to Unaudited Interim Consolidated Financial Statements*

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**PRUDENTIAL FINANCIAL, INC.**

**Unaudited Interim Consolidated Statements of Cash Flows**

**Three Months Ended March 31, 2010 and 2009 (in millions)**

| | 2010 | 2009 |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Net income | $ 671 | $ 3 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Realized investment (gains) losses, net | (389) | (138) |
| Policy charges and fee income | (277) | (450) |
| Interest credited to policyholders account balances | 1,235 | 1,169 |
| Depreciation and amortization | (31) | 142 |
| Gains on trading account assets supporting insurance liabilities, net | (253) | (148) |
| Change in: | | |
| Deferred policy acquisition costs | (294) | 624 |
| Future policy benefits and other insurance liabilities | 930 | 1,373 |
| Other trading account assets | (298) | 539 |
| Income taxes | (1,238) | 322 |
| Other, net | (107) | (900) |
| **Cash flows from (used in) operating activities** | (51) | 2,536 |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Proceeds from the sale/maturity/prepayment of: | | |
| Fixed maturities, available for sale | 5,598 | 13,174 |
| Fixed maturities, held to maturity | 114 | 62 |
| Trading account assets supporting insurance liabilities and other trading account assets | 14,974 | 8,234 |
| Equity securities, available for sale | 833 | 243 |
| Commercial mortgage and other loans | 997 | 834 |
| Policy loans | 418 | 427 |
| Other long-term investments | 106 | 290 |
| Short-term investments | 4,332 | 6,868 |
| Payments for the purchase/origination of: | | |
| Fixed maturities, available for sale | (9,600) | (13,472) |
| Fixed maturities, held to maturity | (57) | (573) |
| Trading account assets supporting insurance liabilities and other trading account assets | (15,098) | (9,114) |
| Equity securities, available for sale | (750) | (194) |
| Commercial mortgage and other loans | (487) | (775) |
| Policy loans | (379) | (446) |
| Other long-term investments | (117) | (419) |
| Short-term investments | (4,691) | (6,104) |
| Other, net | 137 | (66) |
| **Cash flows used in investing activities** | (3,670) | (1,031) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | |
| Policyholders account deposits | 5,302 | 7,914 |
| Policyholders account withdrawals | (5,859) | (6,517) |
| Net change in securities sold under agreements to repurchase and cash collateral for loaned securities | 145 | (410) |
| Cash dividends paid on Common Stock | (34) | (31) |
| Net change in financing arrangements (maturities 90 days or less) | 108 | (1,906) |
| Common Stock reissued for exercise of stock options | 30 | 9 |
| Proceeds from the issuance of debt (maturities longer than 90 days) | 1,407 | 964 |
| Repayments of debt (maturities longer than 90 days) | (1,020) | (2,257) |
| Excess tax benefits from share-based payment arrangements | 5 | 0 |
| Other, net | 201 | 59 |

| | | |
|---|---|---|
| **Cash flows from (used in) financing activities** | 285 | (2,175) |
| Effect of foreign exchange rate changes on cash balances | (102) | (22) |
| **NET DECREASE IN CASH AND CASH EQUIVALENTS** | (3,538) | (692) |
| **CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR** | 13,164 | 15,028 |
| **CASH AND CASH EQUIVALENTS, END OF PERIOD** | $ 9,626 | $ 14,336 |
| **NON-CASH TRANSACTIONS DURING THE PERIOD** | | |
| Treasury Stock shares issued for stock-based compensation programs | $ 67 | $ 96 |

*See Notes to Unaudited Interim Consolidated Financial Statements*

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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, investment management, and real estate services. 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 and Investments. The Company s real estate and relocation services business as well as businesses that are not sufficiently material to warrant separate disclosure and 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. 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, 2009.

***Use of Estimates***

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

The most significant estimates include those used in determining deferred policy acquisition costs and related amortization; valuation 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.

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**PRUDENTIAL FINANCIAL, INC.**

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

***Reclassifications***

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

**2. SIGNIFICANT ACCOUNTING POLICIES AND PRONOUNCEMENTS**

***Investments in Debt and Equity Securities***

The Company s investments in debt and equity securities include fixed maturities; trading account assets; equity securities; and short-term investments. The accounting policies related to these are as follows:

Fixed maturities are comprised of bonds, notes and redeemable preferred stock. Fixed maturities classified as available for sale are carried at fair value. See Note 13 for additional information regarding the determination of fair value. Fixed maturities that the Company has both the positive intent and ability to hold to maturity are carried at amortized cost and classified as held to maturity. The amortized cost of fixed maturities is adjusted for amortization of premiums and accretion of discounts to maturity. Interest income, as well as the related amortization of premium and accretion of discount, is included in Net investment income under the effective yield method. For mortgage-backed and asset-backed securities, the effective yield is based on estimated cash flows, including prepayment assumptions based on data from widely accepted third-party data sources or internal estimates. In addition to prepayment assumptions, cash flow estimates vary based on assumptions regarding the underlying collateral, including default rates and changes in value. These assumptions can significantly impact income recognition and the amount of other-than-temporary impairments recognized in earnings and other comprehensive income. For high credit quality mortgage-backed and asset-backed securities (those rated AA or above), cash flows are provided quarterly, and the amortized cost and effective yield of the security are adjusted as necessary to reflect historical prepayment experience and changes in estimated future prepayments. The adjustments to amortized cost are recorded as a charge or credit to net investment income in accordance with the retrospective method. For asset-backed and mortgage-backed securities rated below AA, 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, as well as the impact of the Company s adoption on January 1, 2009 of new authoritative guidance for the recognition and presentation of other-than-temporary impairments for debt securities. Unrealized gains and losses on fixed maturities classified as available for sale, net of tax, and the effect on deferred policy acquisition costs, valuation of business acquired, deferred sales inducements, future policy benefits and policyholders dividends that would result from the realization of unrealized gains and losses, are included in Accumulated other comprehensive income (loss).

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 investments and certain derivatives, including those used by the Company in its capacity as a broker-dealer. 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. Interest and dividend income from these investments is reported in Net investment income.

Equity securities available for sale are comprised of common stock, mutual fund shares, non-redeemable preferred stock, and perpetual preferred stock, and are carried at fair value. The associated unrealized gains and losses, net of tax, and the effect on deferred policy acquisition costs, valuation of business acquired, deferred

**PRUDENTIAL FINANCIAL, INC.**

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

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 declared.

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 our broker-dealer operations are marked-to-market through Asset management fees and other income.

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

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

In addition, in April 2009, the Financial Accounting Standards Board ( FASB ) revised the authoritative guidance for the recognition and presentation of other-than-temporary impairments for debt securities. The Company early adopted this guidance on January 1, 2009. Prior to the adoption of this guidance the Company was required to record an other-than-temporary impairment for a debt security unless it could assert that it had both the intent and ability to hold the security for a period of time sufficient to allow for a recovery in its fair value to its amortized cost basis. The revised guidance indicates that 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.

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

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, 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 two 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). Prior to the adoption of this guidance in 2009, an other-than-temporary impairment recognized in earnings for debt securities was equal to the total difference between amortized cost and fair value at the time of impairment.

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 prepayment assumptions, and are based on data from widely accepted third-party data sources or internal estimates. In addition to prepayment assumptions, cash flow estimates include 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 based on prospective changes in cash flow estimates, to reflect adjustments to the effective yield.

***Derivative Financial Instruments***

Derivatives are financial instruments whose values are derived from interest rates, foreign exchange rates, financial indices or the values of securities or commodities. 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. Values can be affected by changes in 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.

Derivatives are used in a non-dealer or broker capacity in insurance, investment and international businesses as well as treasury operations to manage the characteristics of the Company s asset/liability mix, to manage the

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**PRUDENTIAL FINANCIAL, INC.**

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

interest rate and currency characteristics of assets or liabilities and to mitigate the risk of a diminution, upon translation to U.S. dollars, of expected non-U.S. earnings and net investments in foreign operations resulting from unfavorable 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-dealer or broker related derivatives, with the exception of the effective portion of cash flow hedges and effective hedges of net investments in foreign operations, are recorded in current earnings. Cash flows from these derivatives are reported in the operating, investing, or financing activities sections in the Unaudited Interim Consolidated Statements of Cash Flows.

Derivatives are also used in a derivative dealer or broker capacity in the Company s 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 or prices of securities and commodities. Realized and unrealized changes in fair value of derivatives used in these dealer related operations are included in Asset management fees and other income 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.

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)" 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

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

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. The 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 amortized to the income statement line associated with the hedged cash flows consistent with the earnings impact of the original hedged cash flows.

When hedge accounting is discontinued because the hedged item no longer meets the definition of a firm commitment, or because it is probable that the forecasted transaction will not occur by the end of the specified time period, the derivative will continue to be carried on the balance sheet at its fair value, with changes in fair value recognized currently in Realized investment gains (losses), net. Any asset or liability that was recorded pursuant to recognition of the firm commitment is removed from the balance sheet and recognized currently in Realized investment gains (losses), net. Gains and losses that were in 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, the identification of which involves judgment. At inception, the Company assesses whether the economic characteristics of the embedded derivative 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 derivative 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 derivative is separated from the host contract, carried at fair value, and changes in its fair value are included in Realized investment gains (losses), net. For certain financial instruments that contain an embedded derivative that otherwise would need to be bifurcated and reported at fair value, the Company may elect to classify the entire instrument as a trading account asset and report it within Other trading account assets, at fair value.

***Adoption of New Accounting Pronouncements***

In January 2010, the FASB issued updated guidance that requires new fair value disclosures about significant transfers between Level 1 and 2 measurement categories and separate presentation of purchases, sales, issuances, and settlements within the roll forward of Level 3 activity. Also, this updated fair value guidance

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**PRUDENTIAL FINANCIAL, INC.**

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

clarifies the disclosure requirements about level of disaggregation and valuation techniques and inputs. This new guidance is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of Level 3 activity, which are effective for interim and annual reporting periods beginning after December 15, 2010. The Company adopted this guidance effective January 1, 2010. The required disclosures are provided in Note 13.

In June 2009, the FASB issued authoritative guidance which changes the analysis required to determine whether or not an entity is a variable interest entity ( VIE ). In addition, the guidance changes the determination of the primary beneficiary of a VIE from a quantitative to a qualitative model. Under the new qualitative model, the primary beneficiary must have both the ability to direct the activities of the VIE and the obligation to absorb either losses or gains that could be significant to the VIE. This guidance also changes when reassessment is needed, as well as requires enhanced disclosures, including the effects of a company s involvement with a VIE on its financial statements. This guidance is effective for interim and annual reporting periods beginning after November 15, 2009. In February 2010, the FASB issued updated guidance which defers, except for disclosure requirements, the impact of this guidance for entities that (1) possess the attributes of an investment company, (2) do not require the reporting entity to fund losses, and (3) are not financing vehicles or entities that were formerly classified as qualified special purpose entities ( QSPE s ). The Company s adoption of this guidance effective January 1, 2010 did not have a material effect on the Company s consolidated financial position and results of operations. The disclosures required by this revised guidance are provided in Note 5.

In June 2009, the FASB issued authoritative guidance which changes the accounting for transfers of financial assets, and is effective for transfers of financial assets occurring in interim and annual reporting periods beginning after November 15, 2009. It removes the concept of a QSPE from the guidance for transfers of financial assets and removes the exception from applying the guidance for consolidation of variable interest entities to qualifying special-purpose entities. It changes the criteria for achieving sale accounting when transferring a financial asset and changes the initial recognition of retained beneficial interests. The guidance also defines participating interest to establish specific conditions for reporting a transfer of a portion of a financial asset as a sale. The Company s adoption of this guidance effective January 1, 2010 did not have a material effect on the Company s consolidated financial position, results of operations, and financial statement disclosures.

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

In April 2010, the FASB issued guidance that amends the accounting for modification of loans that are part of a pool accounted for as a single asset. Under this guidance, modification of loans accounted for within a pool under provisions for loans acquired with deteriorated credit quality, does not result in removal of such loans from the pool even if the modification would otherwise be considered a troubled debt restructuring. An entity must continue to consider whether the pool of assets in which the modified loan is included is impaired if expected cash flows for the pool change. This guidance does not affect the accounting for loans acquired with deteriorated credit quality that are not accounted for within a pool. Loans accounted for individually that were acquired with deteriorated credit quality continue to be subject to the accounting provisions for troubled debt restructuring by creditors. This amended guidance is effective for modifications of loans accounted for within a pool that occur in the first interim or annual reporting period ending on or after July 15, 2010. The amended guidance is to be applied prospectively, with early application permitted. The Company will adopt this guidance effective July 1, 2010, and is currently assessing the impact of the guidance on the Company s consolidated financial position, results of operations, and financial statement disclosures.

In April 2010, the FASB issued guidance clarifying that an insurance entity should not consider any separate account interests in an investment held for the benefit of policyholders to be the insurer s interests, and should not combine those interests with its general account interest in the same investment when assessing the

**PRUDENTIAL FINANCIAL, INC.**

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

investment for consolidation, unless the separate account interests are held for a related party policyholder, whereby consolidation of such interests must be considered under applicable variable interest guidance. This guidance is effective for interim and annual periods beginning after December 15, 2010 and retrospectively to all prior periods upon the date of adoption, with early adoption permitted. The Company will adopt this guidance effective January 1, 2011. The Company is currently assessing the impact of this guidance on the Company s consolidated financial position, results of operations, and financial statement disclosures.

In April 2010, the FASB issued guidance clarifying that an employee share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity s equity securities trades should not be considered to contain a condition that is not a market, performance, or service condition. Therefore, an entity should not classify such an award as a liability if it otherwise qualifies as equity. Disclosure requirements are unchanged. This guidance is effective for interim and annual reporting periods beginning after December 15, 2010, with earlier application permitted. The Company s adoption of this guidance effective January 1, 2011 is not expected to have a material effect on the Company s consolidated financial position, results of operations, and financial statement disclosures.

In March 2010, the FASB issued updated guidance that amends and clarifies the accounting for credit derivatives embedded in interests in securitized financial assets. This new guidance eliminates the scope exception for embedded credit derivatives (except for those that are created solely by subordination) and provides new guidance on how the evaluation of embedded credit derivatives is to be performed. This new guidance is effective for the first interim reporting period beginning after June 15, 2010, with early adoption permitted. The Company will adopt this guidance effective with the interim reporting period ending September 30, 2010. The Company is currently assessing the impact of this guidance on the Company s consolidated financial position, results of operations, and financial statement disclosures.

**3. ACQUISITIONS AND DISPOSITIONS**

***Sale of investment in Wachovia Securities***

On December 31, 2009, the Company completed the sale of its minority joint venture interest in Wachovia Securities Financial Holdings, LLC ( Wachovia Securities ), which includes Wells Fargo Advisors, to Wells Fargo & Company ( Wells Fargo ). The Company s minority joint venture interest in Wachovia Securities originated as a result of the Company combining its retail securities brokerage and clearing operations with those of Wachovia Corporation ( Wachovia ) in 2003. On December 31, 2008, Wachovia merged with and into Wells Fargo, which succeeded to Wachovia s rights and obligations under the joint venture arrangements. At the closing, the Company received $4.5 billion in cash as the purchase price of its joint venture interest and de-recognized the carrying value of its investment in the joint venture and the carrying value of the associated lookback option. The pre-tax gain on sale recognized by the Company was $2.247 billion and was reflected in Equity in earnings of operating joint ventures, net of taxes.

***Acquisition of Yamato Life***

On May 1, 2009, the Company s Gibraltar Life operations acquired Yamato Life, a Japanese life insurance company that declared bankruptcy in October 2008. Gibraltar Life served as the reorganization sponsor for Yamato and under the reorganization agreement acquired Yamato by contributing $72 million of capital to Yamato. At the date of acquisition the Company recognized $2.3 billion of assets and $2.3 billion of liabilities related to Yamato. Subsequent to the acquisition, the Company renamed the acquired company The Prudential Gibraltar Financial Life Insurance Company, Ltd.

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

***Discontinued Operations***

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

| | Three Months Ended March 31, | |
|---|---|---|
| | **2010** | **2009** |
| | (in millions) | |
| Korean asset management operations | $ 1 | $ 9 |
| Real estate investments sold or held for sale | 2 | 2 |
| International securities operations | (1) | |
| Income from discontinued operations before income taxes | 2 | 11 |
| Income tax expense | 4 | 7 |
| Income (loss) from discontinued operations, net of taxes | $ (2) | $ 4 |

In the first quarter of 2010, the Company signed a definitive agreement, which is subject to local regulatory approval, to sell Prudential Investment & Securities Co. Ltd. and Prudential Asset Management Co. Ltd., which together comprise the Company s Korean asset management operations. The net proceeds from this agreement are expected to be approximately equal to the book value. The transaction is expected to close in the second quarter of 2010. Also included in the table above are amounts related to currency hedging activities related to these operations.

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:

| | **March 31, 2010** | **December 31, 2009** |
|---|---|---|
| | (in millions) | |
| Total assets | $ 882 | $ 937 |
| Total liabilities | $ 494 | $ 556 |

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**PRUDENTIAL FINANCIAL, INC.**

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

**4. INVESTMENTS**

***Fixed Maturities and Equity Securities***

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

| | March 31, 2010 | | | | |
|---|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses (in millions) | Fair Value | Other-than-temporary impairments in AOCI(3) |
| **Fixed maturities, available for sale** | | | | | |
| U.S. Treasury securities and obligations of U.S. government authorities and agencies | $ 8,943 | $ 404 | $ 384 | $ 8,963 | $ |
| Obligations of U.S. states and their political subdivisions | 1,493 | 37 | 24 | 1,506 | |
| Foreign government bonds | 40,076 | 1,422 | 132 | 41,366 | |
| Corporate securities | 92,545 | 5,286 | 2,168 | 95,663 | (28) |
| Asset-backed securities(1) | 12,300 | 174 | 2,370 | 10,104 | (1,742) |
| Commercial mortgage-backed securities | 11,249 | 529 | 93 | 11,685 | 5 |
| Residential mortgage-backed securities(2) | 10,791 | 465 | 93 | 11,163 | (10) |
| Total fixed maturities, available for sale | $ 177,397 | $ 8,317 | $ 5,264 | $ 180,450 | $ (1,775) |
| **Equity securities, available for sale** | $ 6,082 | $ 1,111 | $ 105 | $ 7,088 | |

(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 $475 million of net unrealized gains on impaired securities relating to changes in the value of such securities subsequent to the impairment measurement date.

| | March 31, 2010 | | | | |
|---|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses (in millions) | Fair Value | Other-than-temporary impairments in AOCI(3) |

| | | | | | |
|---|---|---|---|---|---|
| **Fixed maturities, held to maturity** | | | | | |
| Foreign government bonds | $ 1,043 | $ 17 | $ 4 | $ 1,056 | $ |
| Corporate securities | 912 | 1 | 126 | 787 | |
| Asset-backed securities(1) | 1,076 | 15 | 4 | 1,087 | |
| Commercial mortgage-backed securities | 466 | 114 | | 580 | |
| Residential mortgage-backed securities(2) | 1,519 | 54 | 2 | 1,571 | |
| Total fixed maturities, held to maturity | $ 5,016 | $ 201 | $ 136 | $ 5,081 | $ |

(1) Includes credit tranched securities collateralized by 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.

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**PRUDENTIAL FINANCIAL, INC.**

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

| | December 31, 2009 | | | | |
|---|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses (in millions) | Fair Value | Other-than-temporary impairments in AOCI(3) |
| **Fixed maturities, available for sale** | | | | | |
| U.S. Treasury securities and obligations of U.S. government authorities and agencies | $ 8,254 | $ 384 | $ 370 | $ 8,268 | $ |
| Obligations of U.S. states and their political subdivisions | 1,389 | 28 | 42 | 1,375 | |
| Foreign government bonds | 39,795 | 1,549 | 135 | 41,209 | |
| Corporate securities | 89,915 | 4,377 | 2,746 | 91,546 | (43) |
| Asset-backed securities(1) | 12,587 | 155 | 2,504 | 10,238 | (1,716) |
| Commercial mortgage-backed securities | 11,036 | 202 | 220 | 11,018 | 1 |
| Residential mortgage-backed securities(2) | 11,275 | 428 | 132 | 11,571 | (11) |
| Total fixed maturities, available for sale | $ 174,251 | $ 7,123 | $ 6,149 | $ 175,225 | $ (1,769) |
| **Equity securities, available for sale** | $ 6,106 | $ 1,014 | $ 225 | $ 6,895 | |

(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 $540 million of net unrealized gains on impaired securities relating to changes in the value of such securities subsequent to the impairment measurement date.

| | December 31, 2009 | | | | |
|---|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses (in millions) | Fair Value | Other-than-temporary impairments in AOCI(3) |
| **Fixed maturities, held to maturity** | | | | | |
| Foreign government bonds | $ 1,058 | $ 25 | $ 1 | $ 1,082 | $ |
| Corporate securities | 876 | 1 | 126 | 751 | |
| Asset-backed securities(1) | 1,112 | 16 | 3 | 1,125 | |
| Commercial mortgage-backed securities | 460 | 104 | | 564 | |
| Residential mortgage-backed securities(2) | 1,614 | 64 | 3 | 1,675 | |
| Total fixed maturities, held to maturity | $ 5,120 | $ 210 | $ 133 | $ 5,197 | $ |

(1) Includes credit tranched securities collateralized by 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.

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**PRUDENTIAL FINANCIAL, INC.**

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

The amortized cost and fair value of fixed maturities by contractual maturities at March 31, 2010, are as follows:

| | Available for Sale | | Held to Maturity | |
|---|---|---|---|---|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| | (in millions) | | (in millions) | |
| Due in one year or less | $ 11,675 | $ 11,912 | $ | $ |
| Due after one year through five years | 36,235 | 37,493 | 48 | 48 |
| Due after five years through ten years | 31,271 | 32,471 | 75 | 75 |
| Due after ten years | 63,876 | 65,622 | 1,832 | 1,720 |
| Asset-backed securities | 12,300 | 10,104 | 1,076 | 1,087 |
| Commercial mortgage-backed securities | 11,249 | 11,685 | 466 | 580 |
| Residential mortgage-backed securities | 10,791 | 11,163 | 1,519 | 1,571 |
| Total | $ 177,397 | $ 180,450 | $ 5,016 | $ 5,081 |

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

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2010 | 2009 |
| | (in millions) | |
| **Fixed maturities, available for sale** | | |
| Proceeds from sales | $ 2,248 | $ 8,643 |
| Proceeds from maturities/repayments | 3,457 | 4,025 |
| Gross investment gains from sales, prepayments, and maturities | 89 | 363 |
| Gross investment losses from sales and maturities | (58) | (117) |
| **Fixed maturities, held to maturity** | | |
| Gross investment gains from prepayments | $ | $ |
| Proceeds from maturities/repayments | 114 | 62 |
| **Fixed maturity and equity security impairments** | | |
| Net writedowns for other-than-temporary impairment losses on fixed maturities recognized in earnings(1) | $ (254) | $ (605) |
| Writedowns for impairments on equity securities | (69) | (493) |

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

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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**

| | (in millions) |
|---|---|
| Balance, December 31, 2009 | $ 1,747 |
| Credit loss impairments previously recognized on securities which matured, paid down, prepaid or were sold during the period | (192) |
| Credit loss impairments previously recognized on securities impaired to fair value during the period(1) | (7) |
| Credit loss impairment recognized in the current period on securities not previously impaired | 114 |
| Additional credit loss impairments recognized in the current period on securities previously impaired | 81 |
| Increases due to the passage of time on previously recorded credit losses | 29 |
| Accretion of credit loss impairments previously recognized due to an increase in cash flows expected to be collected | (19) |
| Balance, March 31, 2010 | $ 1,753 |

(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.

***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:

| | March 31, 2010 | | December 31, 2009 | |
|---|---|---|---|---|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| | (in millions) | | (in millions) | |
| Short-term investments and cash equivalents | $ 752 | $ 752 | $ 725 | $ 725 |
| Fixed maturities: | | | | |
| Corporate securities | 9,342 | 9,776 | 9,202 | 9,502 |
| Commercial mortgage-backed securities | 1,930 | 1,937 | 1,899 | 1,893 |
| Residential mortgage-backed securities | 1,379 | 1,384 | 1,434 | 1,432 |
| Asset-backed securities | 1,134 | 987 | 1,022 | 857 |
| Foreign government bonds | 497 | 504 | 508 | 517 |
| U.S. government authorities and agencies and obligations of U.S. states | 334 | 326 | 169 | 159 |
| Total fixed maturities | 14,616 | 14,914 | 14,234 | 14,360 |
| Equity securities | 1,047 | 1,017 | 1,033 | 935 |
| Total trading account assets supporting insurance liabilities | $ 16,415 | $ 16,683 | $ 15,992 | $ 16,020 |

The net change in unrealized gains (losses) from trading account assets supporting insurance liabilities still held at period end, recorded within "Asset management fees and other income" was $240 million and $245 million during the three months ended March 31, 2010 and 2009 respectively.

**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:

| | March 31, 2010 | | December 31, 2009 | |
|---|---|---|---|---|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| | (in millions) | | (in millions) | |
| Short-term investments and cash equivalents | $ 5 | $ 5 | $ 5 | $ 5 |
| Fixed Maturities: | | | | |
| Asset-backed securities | 726 | 687 | 1,043 | 991 |
| Residential mortgage-backed securities | 314 | 183 | 287 | 158 |
| Corporate securities | 324 | 334 | 345 | 359 |
| Commercial mortgage-backed securities | 192 | 120 | 239 | 136 |
| U.S. government authorities and agencies and obligations of U.S. states | 318 | 323 | 90 | 95 |
| Foreign government bonds | 22 | 23 | 23 | 24 |
| Total fixed maturities | 1,896 | 1,670 | 2,027 | 1,763 |
| Derivative instruments and other | 1,033 | 1,210 | 662 | 794 |
| Equity securities | 464 | 486 | 456 | 471 |
| Total other trading account assets | $ 3,398 | $ 3,371 | $ 3,150 | $ 3,033 |

The net change in unrealized gains (losses) from other trading account assets still held at period end, recorded within Asset management fees and other income were $90 million, and $(29) million during the three months ended March 31, 2010, and 2009, respectively.

***Net Investment Income***

Net investment income for the three months ended March 31, 2010 and 2009 was from the following sources:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2010 | 2009 |
| | (in millions) | |
| Fixed maturities, available for sale | $ 2,054 | $ 2,084 |

| | | |
|---|---|---|
| Fixed maturities, held to maturity | 34 | 31 |
| Equity securities, available for sale | 70 | 77 |
| Trading account assets | 203 | 207 |
| Commercial mortgage and other loans | 455 | 483 |
| Policy loans | 142 | 137 |
| Broker-dealer related receivables | 3 | 6 |
| Short-term investments and cash equivalents | 11 | 60 |
| Other long-term investments | 4 | (106) |
| Gross investment income | 2,976 | 2,979 |
| Less investment expenses | (102) | (130) |
| Net investment income | $ 2,874 | $ 2,849 |

**PRUDENTIAL FINANCIAL, INC.**

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

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

Realized investment gains (losses), net, for the three months ended March 31, 2010 and 2009 were from the following sources:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2010 | 2009 |
| | (in millions) | |
| Fixed maturities | $ (223) | $ (359) |
| Equity securities | 41 | (501) |
| Commercial mortgage and other loans | (7) | (122) |
| Investment real-estate | | (14) |
| Joint ventures and limited partnerships | (2) | (14) |
| Derivatives(1) | 576 | 1,145 |
| Other | 4 | 3 |
| Realized investment gains (losses), net | $ 389 | $ 138 |

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

***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 | Deferred Policy Acquisition Costs, Deferred | Future Policy Benefits | Policyholders Dividends | Deferred Income Tax (Liability) Benefit | Accumulated Other Comprehensive Income (Loss) |
|---|---|---|---|---|---|---|

| | Investments | Sales Inducements, and Valuation of Business Acquired | | | | Related To Net Unrealized Investment Gains (Losses) |
|---|---|---|---|---|---|---|
| | | | (in millions) | | | |
| Balance, December 31, 2009 | $ (1,229) | $ 193 | $ 2 | $ | $ 355 | $ (679) |
| Net investment gains (losses) on investments arising during the period | (148) | | | | 52 | (96) |
| Reclassification adjustment for (gains) losses included in net income | 95 | | | | (33) | 62 |
| Reclassification adjustment for OTTI losses excluded from net income(1) | (18) | | | | 6 | (12) |
| Impact of net unrealized investment (gains) losses on deferred policy acquisition costs, deferred sales inducements and valuation of business acquired | | (89) | | | 31 | (58) |
| Impact of net unrealized investment (gains) losses on future policy benefits | | | (10) | | 4 | (6) |
| Impact of net unrealized investment (gains) losses on policyholders dividends | | | | 268 | (94) | 174 |
| Balance, March 31, 2010 | $ (1,300) | $ 104 | $ (8) | $ 268 | $ 321 | $ (615) |

(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*

| | Net Unrealized Gains/ (Losses) on Investments(1) | Deferred Policy Acquisition Costs, Deferred Sales Inducements, and Valuation of Business Acquired | Future Policy Benefits | Policyholders Dividends | Deferred Income Tax (Liability) Benefit | Accumulated Other Comprehensive Income (Loss) Related To Net Unrealized Investment Gains (Losses) |
|---|---|---|---|---|---|---|
| | | | | (in millions) | | |
| Balance, December 31, 2009 | $ 2,885 | $ (803) | $ (509) | $ | $ (383) | $ 1,190 |
| Net investment gains (losses) on investments arising during the period | 2,401 | | | | (815) | 1,586 |
| Reclassification adjustment for (gains) losses included in net income | 87 | | | | (30) | 57 |
| Reclassification adjustment for OTTI losses excluded from net income(2) | 18 | | | | (6) | 12 |
| Impact of net unrealized investment (gains) losses on deferred policy acquisition costs, deferred sales inducements and valuation of business acquired | | (46) | | | 16 | (30) |
| Impact of net unrealized investment (gains) losses on future policy benefits | | | (104) | | 36 | (68) |
| Impact of net unrealized investment (gains) losses on policyholders dividends | | | | (835) | 292 | (543) |
| Balance, March 31, 2010 | $ 5,391 | $ (849) | $ (613) | $ (835) | $ (890) | $ 2,204 |

(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:

| | March 31, 2010 | December 31, 2009 |
|---|---|---|
| | (in millions) | |
| Fixed maturity securities on which an OTTI loss has been recognized | $ (1,300) | $ (1,229) |
| Fixed maturity securities, available for sale all other | 4,353 | 2,203 |

| | | |
|---|---|---|
| Equity securities, available for sale | 1,006 | 789 |
| Derivatives designated as cash flow hedges(1) | (256) | (317) |
| Other investments(2) | 288 | 210 |
| Net unrealized gains (losses) on investments | $ 4,091 | $ 1,656 |

(1) See Note 14 for more information on cash flow hedges.
(2) Includes $248 million of net unrealized losses on held to maturity securities that were transferred from available for sale.

**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:

| | March 31, 2010 | | | | | |
|---|---|---|---|---|---|---|
| | Less than twelve months | | Twelve months or more | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| | (in millions) | | | | | |
| **Fixed maturities(1)** | | | | | | |
| U.S. Treasury securities and obligations of U.S. government authorities and agencies | $ 3,100 | $ 185 | $ 866 | $ 199 | $ 3,966 | $ 384 |
| Obligations of U.S. states and their political subdivisions | 703 | 24 | 8 | | 711 | 24 |
| Foreign government bonds | 3,048 | 27 | 3,645 | 109 | 6,693 | 136 |
| Corporate securities | 9,122 | 312 | 14,486 | 1,982 | 23,608 | 2,294 |
| Commercial mortgage-backed securities | 217 | 2 | 819 | 91 | 1,036 | 93 |
| Asset-backed securities | 368 | 8 | 6,631 | 2,366 | 6,999 | 2,374 |
| Residential mortgage-backed securities | 549 | 2 | 1,200 | 93 | 1,749 | 95 |
| Total | $ 17,107 | $ 560 | $ 27,655 | $ 4,840 | $ 44,762 | $ 5,400 |

(1) Includes $1,491 million of fair value and $136 million of gross unrealized losses at March 31, 2010 on securities classified as held to maturity, a portion of which are not reflected in accumulated other comprehensive income.

| | December 31, 2009 | | | | | |
|---|---|---|---|---|---|---|
| | Less than twelve months | | Twelve months or more | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| | (in millions) | | | | | |
| **Fixed maturities(1)** | | | | | | |
| U.S. Treasury securities and obligations of U.S. government authorities and agencies | $ 4,058 | $ 259 | $ 475 | $ 111 | $ 4,533 | $ 370 |
| Obligations of U.S. states and their political subdivisions | 936 | 42 | 7 | | 943 | 42 |
| Foreign government bonds | 5,027 | 95 | 498 | 41 | 5,525 | 136 |
| Corporate securities | 10,388 | 352 | 17,414 | 2,520 | 27,802 | 2,872 |
| Commercial mortgage-backed securities | 1,471 | 40 | 3,216 | 180 | 4,687 | 220 |
| Asset-backed securities | 1,619 | 565 | 6,128 | 1,942 | 7,747 | 2,507 |
| Residential mortgage-backed securities | 1,567 | 21 | 1,150 | 114 | 2,717 | 135 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Total | $ 25,066 | $ 1,374 | $ 28,888 | $ 4,908 | $ 53,954 | $ 6,282 |

(1) Includes $1,216 million of fair value and $133 million of gross unrealized losses at December 31, 2009 on securities classified as held to maturity, a portion of which are not reflected in accumulated other comprehensive income.

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**PRUDENTIAL FINANCIAL, INC.**

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

The gross unrealized losses at March 31, 2010 and December 31, 2009 are composed of $3,592 million and $4,240 million related to high or highest quality securities based on NAIC or equivalent rating and $1,808 million and $2,042 million, respectively, related to other than high or highest quality securities based on NAIC or equivalent rating. At March 31, 2010, $3,074 million of the gross unrealized losses represented declines in value of greater than 20%, $482 million of which had been in that position for less than six months, as compared to $3,594 million at December 31, 2009 that represented declines in value of greater than 20%, $588 million of which had been in that position for less than six months. At March 31, 2010, the $4,840 million of gross unrealized losses of twelve months or more were concentrated in asset backed securities, and in the manufacturing, finance, and services sectors of the Company s corporate securities. At December 31, 2009, the $4,908 million of gross unrealized losses of twelve months or more were concentrated in asset backed securities, and in the manufacturing and finance 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 March 31, 2010 or December 31, 2009. 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 credit spread widening and increased liquidity discounts. At March 31, 2010, 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:

| | March 31, 2010 | | | | | |
|---|---|---|---|---|---|---|
| | Less than twelve months | | Twelve months or more | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| | (in millions) | | | | | |
| Equity securities, available for sale | $ 874 | $ 57 | $ 428 | $ 48 | $ 1,302 | $ 105 |

| | December 31, 2009 | | | | | |
|---|---|---|---|---|---|---|
| | Less than twelve months | | Twelve months or more | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| | (in millions) | | | | | |
| Equity securities, available for sale | $ 1,159 | $ 142 | $ 754 | $ 83 | $ 1,913 | $ 225 |

At March 31, 2010, $24 million of the gross unrealized losses represented declines of greater than 20%, $8 million of which had been in that position for less than six months. At December 31, 2009, $62 million of the gross unrealized losses represented declines of greater than 20%, $37 million of which had been in that position for less than six months. Perpetual preferred securities have characteristics of both debt and equity securities. Since an impairment model similar to fixed maturity securities is applied to these securities, an other-than-temporary impairment has

not been recognized on certain perpetual preferred securities that have been in a continuous unrealized loss position for twelve months or more as of March 31, 2010 and December 31, 2009. 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 March 31, 2010 or December 31, 2009.

**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 VIE s 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 VIE s, 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 Sponsor***

The Company is the sponsor 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 proprietary investing activity of the Company s asset 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 sponsor, (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 sponsor.

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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 that it sponsors, including one CDO and certain 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 sponsor are reported. The assets of these VIE s 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.

| | March 31, 2010 | December 31, 2009 |
|---|---|---|
| | (in millions) | |
| Fixed maturities, available for sale | $ 61 | $ 68 |
| Trading account assets supporting insurance liabilities | 6 | 7 |
| Commercial mortgage and other loans | 402 | 412 |
| Other long-term investments | 7 | 10 |
| Cash and cash equivalents | 43 | 44 |
| Accrued investment income | 2 | 2 |
| Other assets | 4 | 4 |
| Separate account assets | 36 | 38 |
| Total assets of consolidated VIEs | $ 561 | $ 585 |
| Long-term debt | $ 413 | $ 413 |
| Separate account liabilities | 36 | 38 |
| Total liabilities of consolidated VIEs | $ 449 | $ 451 |

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 sponsor 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.

| | March 31, 2010 | December 31, 2009 |
|---|---|---|
| | (in millions) | |
| Fixed maturities, available for sale | $ 106 | $ 107 |
| Fixed maturities, held to maturity | 981 | 985 |
| Other long-term investments | (22) | (48) |
| Accrued investment income | 4 | 4 |
| Total assets of consolidated VIEs | $ 1,069 | $ 1,048 |
| Total liabilities of consolidated VIEs | $ | $ |

**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 $4,301 million and $4,927 million at March 31, 2010 and December 31, 2009, 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 that it sponsors, 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 it sponsors is limited to its investment in the VIEs, which was $380 million at March 31, 2010 and December 31, 2009. These investments are reflected in Fixed maturities, available for sale. The fair value of assets held within these unconsolidated VIEs was $6,978 million and $6,988 million as of March 31, 2010 and December 31, 2009, 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 $3,304 million and $3,251 million as of March 31, 2010 and December 31, 2009, 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 sponsor. 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)**

$6.0 billion and $7.5 billion as of March 31, 2010 and December 31, 2009, 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 $747 million and $723 million at March 31, 2010 and December 31, 2009, 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 March 31, 2010, the Company has not recognized a policyholder dividend obligation for the excess of actual cumulative earnings over the expected cumulative earnings. Actual cumulative earnings are below the expected cumulative earnings by $357 million. However, accumulated net unrealized investment gains that have arisen subsequent to the establishment of the Closed Block have been reflected as a policyholder dividend obligation of $565 million at March 31, 2010, to be paid to Closed Block policyholders unless offset by future experience, with an offsetting amount reported in Accumulated other comprehensive income. As of December 31, 2009, actual cumulative earnings were below the expected cumulative earnings, thereby eliminating the policyholder dividend obligation. Furthermore, the accumulation of net unrealized investment gains as of December 31, 2009 that had arisen subsequent to the establishment of the Closed Block, were not sufficient to overcome the cumulative earnings shortfall. See the table below for changes in the components of the policyholder dividend obligation for the three months ended March 31, 2010.

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:

| | March 31, 2010 | December 31, 2009 |
|---|---|---|
| | (in millions) | |
| **Closed Block Liabilities** | | |
| Future policy benefits | $ 51,636 | $ 51,774 |
| Policyholders dividends payable | 966 | 926 |
| Policyholders dividend obligation | 565 | |
| Policyholders account balances | 5,569 | 5,588 |
| Other Closed Block liabilities | 4,488 | 4,300 |
| Total Closed Block Liabilities | 63,224 | 62,588 |
| **Closed Block Assets** | | |
| Fixed maturities, available for sale, at fair value | 39,480 | 38,448 |
| Other trading account assets, at fair value | 148 | 166 |
| Equity securities, available for sale, at fair value | 3,211 | 3,037 |
| Commercial mortgage and other loans | 7,589 | 7,751 |
| Policy loans | 5,398 | 5,418 |
| Other long-term investments | 1,697 | 1,597 |
| Short-term investments | 1,047 | 1,218 |
| Total investments | 58,570 | 57,635 |
| Cash and cash equivalents | 550 | 662 |
| Accrued investment income | 655 | 608 |
| Other Closed Block assets | 446 | 307 |
| Total Closed Block Assets | 60,221 | 59,212 |
| Excess of reported Closed Block Liabilities over Closed Block Assets | 3,003 | 3,376 |
| Portion of above representing accumulated other comprehensive income: | | |
| Net unrealized investment gains (losses) | 917 | 231 |

| | | |
|---|---|---|
| Allocated to policyholder dividend obligation | (565) | |
| Future earnings to be recognized from Closed Block Assets and Closed Block Liabilities | $ 3,355 | $ 3,607 |

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**PRUDENTIAL FINANCIAL, INC.**

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

Information regarding the policyholder dividend obligation is as follows:

| | Three Months Ended March 31, 2010 (in millions) |
|---|---|
| Balance, January 1 | $ |
| Impact from earnings allocable to policyholder dividend obligation | |
| Change in net unrealized investment gains (losses) allocated to policyholder dividend obligation | 565 |
| Balance, March 31 | $ 565 |

Closed Block revenues and benefits and expenses for the three months ended March 31, 2010 and 2009 were as follows:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2010 | 2009 |
| | (in millions) | |
| **Revenues** | | |
| Premiums | $ 711 | $ 773 |
| Net investment income | 735 | 718 |
| Realized investment gains (losses), net | 278 | (408) |
| Other income | 7 | 15 |
| Total Closed Block revenues | 1,731 | 1,098 |
| **Benefits and Expenses** | | |
| Policyholders benefits | 840 | 912 |
| Interest credited to policyholders account balances | 35 | 35 |
| Dividends to policyholders | 491 | 3 |
| General and administrative expenses | 139 | 145 |
| Total Closed Block benefits and expenses | 1,505 | 1,095 |
| Closed Block revenues, net of Closed Block benefits and expenses, before income taxes and discontinued operations | 226 | 3 |
| Income tax expense (benefit) | (26) | 5 |
| Closed Block revenues, net of Closed Block benefits and expenses and income taxes, before discontinued operations | 252 | (2) |
| Income from discontinued operations, net of taxes | | |

| | | |
|---|---|---|
| Closed Block revenues, net of Closed Block benefits and expenses, income taxes and discontinued operations | $ 252 | $ (2) |

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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 | | | Class B Stock |
|---|---|---|---|---|
| | Issued | Held In Treasury | Outstanding | Issued and Outstanding |
| | (in millions) | | | |
| **Balance, December 31, 2009** | 641.8 | 179.7 | 462.1 | 2.0 |
| Common Stock issued | | | | |
| Common Stock acquired | | | | |
| Stock-based compensation programs(1) | | (1.5) | 1.5 | |
| **Balance, March 31, 2010** | 641.8 | 178.2 | 463.6 | 2.0 |

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

***Comprehensive Income***

The components of comprehensive income (loss) are as follows:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2010 | 2009 |
| | (in millions) | |
| Net income | $ 671 | $ 3 |
| Other comprehensive income (loss), net of taxes: | | |
| Change in foreign currency translation adjustments | (35) | (328) |
| Change in net unrealized investments gains (losses)(1) | 1,078 | (267) |
| Change in pension and postretirement unrecognized net periodic benefit | 20 | 9 |
| Other comprehensive income (loss)(2) | 1,063 | (586) |
| Comprehensive income (loss) | 1,734 | (583) |

| | | |
|---|---|---|
| Comprehensive loss attributable to noncontrolling interests | 26 | 51 |
| Comprehensive income (loss) attributable to Prudential Financial, Inc. | $ 1,760 | $ (532) |

(1) Includes cash flow hedges of $40 million and $25 million for the three months ended March 31, 2010 and 2009, 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).

(2) Amounts are net of tax expense (benefit) of $524 million and $(227) million for the three months ended March 31, 2010 and 2009, respectively.

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**PRUDENTIAL FINANCIAL, INC.**

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

The balance of and changes in each component of Accumulated other comprehensive income (loss) attributable to Prudential Financial, Inc. for the three months ended March 31, 2010 and 2009 are as follows (net of taxes):

| | Accumulated Other Comprehensive Income (Loss) Attributable to Prudential Financial, Inc. | | | |
|---|---|---|---|---|
| | Foreign Currency Translation Adjustment | Net Unrealized Investment Gains (Losses)(1) | Pension and Postretirement Unrecognized Net Periodic Benefit (Cost) | Total Accumulated Other Comprehensive Income (Loss) |
| | (in millions) | | | |
| Balance, December 31, 2009 | $ 674 | $ 511 | $ (1,628) | $ (443) |
| Change in component during period | (35) | 1,078 | 20 | 1,063 |
| Balance, March 31, 2010 | $ 639 | $ 1,589 | $ (1,608) | $ 620 |

| | Accumulated Other Comprehensive Income (Loss) Attributable to Prudential Financial, Inc. | | | |
|---|---|---|---|---|
| | Foreign Currency Translation Adjustment | Net Unrealized Investment Gains (Losses)(1) | Pension and Postretirement Unrecognized Net Periodic Benefit (Cost) | Total Accumulated Other Comprehensive Income (Loss) |
| | (in millions) | | | |
| Balance, December 31, 2008 | $ 375 | $ (6,735) | $ (983) | $ (7,343) |
| Change in component during period | (276) | (279) | 9 | (546) |
| Impact of adoption of guidance for other-than- temporary impairments of debt securities(2) | | (686) | | (686) |
| Balance, March 31, 2009 | $ 99 | $ (7,700) | $ (974) | $ (8,575) |

(1) Includes cash flow hedges $(165) million and $(205) million as of March 31, 2010 and December 31, 2009 respectively and $(122) million and $(147) million as of March 31, 2009 and December 31, 2008 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).

(2) See Note 2 for additional information on the adoption of guidance for other-than-temporary impairments of debt securities.

**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.

**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:

| | Three Months Ended March 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2010 | | | 2009 | | |
| | Income | Weighted Average Shares | Per Share Amount | Income | Weighted Average Shares | Per Share Amount |
| | (in millions except per share amounts) | | | | | |
| **Basic earnings per share** | | | | | | |
| Income (loss) from continuing operations attributable to the Financial Services Businesses | $ 512 | | | $ (20) | | |
| Direct equity adjustment | 10 | | | 11 | | |
| Less: Income (loss) attributable to noncontrolling interests | (26) | | | (11) | | |
| Less: Earnings allocated to participating unvested share-based payment awards | 7 | | | | | |
| Income from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment | $ 541 | 463.0 | $ 1.17 | $ 2 | 422.1 | $ 0.00 |
| **Effect of dilutive securities and compensation programs** | | | | | | |
| Add: Earnings allocated to participating unvested share-based payment awards Basic | $ 7 | | | $ | | |
| Less: Earnings allocated to participating unvested share-based payment awards Diluted | 7 | | | | | |
| Stock options | | 2.9 | | | 0.1 | |
| Deferred and long-term compensation programs | | 0.5 | | | 1.0 | |
| Exchangeable Surplus Notes | 4 | 5.1 | | | | |
| **Diluted earnings per share** | | | | | | |
| Income from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment | $ 545 | 471.5 | $ 1.16 | $ 2 | 423.2 | $ 0.00 |

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. Undistributed earnings allocated to participating unvested share-based payment awards for the three months ended March 31, 2010 and 2009 were based on 5.8 million and 4.1 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 March 31, 2010 and 2009, 10.9 million and 19.1 million options, respectively, weighted for the portion of the period they were outstanding, with a weighted average exercise price of $71.29 and $54.66 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.

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**PRUDENTIAL FINANCIAL, INC.**

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

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, is added to the denominator, and interest expense, net of tax, is added to the numerator, if the overall effect is dilutive.

As of March 31, 2010, $2 million of senior notes related to the $2.0 billion December 2006 issuance remain outstanding. These will be dilutive to earnings per share if the average market price of the Common Stock for a particular period is above the initial conversion price of $104.21. As of March 31, 2010, $0.2 million of senior notes related to the $3.0 billion December 2007 issuance remain outstanding. These senior notes will be dilutive to earnings per share if the average market price of the Common Stock for a particular period is above the initial conversion price of $132.39.

***Class B Stock***

Income from continuing operations per share of Class B Stock for the three months ended March 31, are presented below. There are no potentially dilutive shares associated with the Class B Stock.

| | Three Months Ended March 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2010 | | | 2009 | | |
| | Income | Weighted Average Shares | Per Share Amount | Income | Weighted Average Shares | Per Share Amount |
| | (in millions except per share amounts) | | | | | |
| **Basic earnings per share** | | | | | | |
| Income from continuing operations attributable to the Closed Block Business | $ 161 | | | $ 19 | | |
| Less: Direct equity adjustment | 10 | | | 11 | | |
| Income from continuing operations attributable to the Closed Block Business available to holders of Class B Stock after direct equity adjustment | $ 151 | 2.0 | $ 75.50 | $ 8 | 2.0 | $ 4.00 |

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

***Commercial Paper***

The Company issues commercial paper under the two programs described below primarily to manage operating cash flows and existing commitments, to meet working capital needs and to take advantage of current investment opportunities. At March 31, 2010 and December 31, 2009, the weighted average maturity of total commercial paper outstanding was 29 and 27 days, respectively.

Prudential Financial has a commercial paper program rated A-1 by Standard & Poor s Rating Services ( S&P ), P-2 by Moody s Investors Service, Inc. ( Moody s ) and F2 by Fitch Ratings Ltd. ( Fitch ) as of March 31, 2010.

Prudential Funding, LLC, a wholly owned subsidiary of Prudential Insurance, has a commercial paper program, rated A-1+ by S&P, P-2 by Moody s and F1 by Fitch as of March 31, 2010. Prudential Financial has issued a subordinated guarantee covering Prudential Funding s domestic commercial paper program.

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**PRUDENTIAL FINANCIAL, INC.**

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

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

| | March 31, 2010 | December 31, 2009 |
|---|---|---|
| | (in millions) | |
| Prudential Financial | $ 143 | $ 146 |
| Prudential Funding, LLC | 733 | 730 |
| Total outstanding commercial paper borrowings | $ 876 | $ 876 |

***Medium-term Notes***

On January 14, 2010, Prudential Financial issued under its Medium-term Notes, Series D program $500 million of 2.75% notes due January 2013 and $750 million of 3.875% notes due January 2015.

***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 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 up to 7% of its prior year-end statutory net admitted assets, excluding separate account assets. This limitation resets to 5% on December 31, 2010 unless extended by NJDOBI. NJDOBI has also limited the aggregate amount of assets that Prudential Insurance may pledge for any loans, including FHLBNY borrowings, up to 10% of its prior year-end statutory net admitted assets, excluding separate account assets; however, this limitation excludes certain activities, such as the asset-based financing transactions described above. Based on Prudential Insurance s statutory net admitted assets as of December 31, 2009, the 7% limitation equates to a maximum amount of pledged assets of $10.4 billion and an estimated maximum borrowing capacity (after taking into account required collateralization levels and purchases of activity-based stock) of approximately $8.7 billion. Nevertheless, FHLBNY borrowings are subject to the FHLBNY s discretion and to the availability of qualifying assets at Prudential Insurance.

As of March 31, 2010, Prudential Insurance had pledged qualifying assets with a fair value of $3.9 billion, which supported outstanding collateralized advances of $2.0 billion and collateralized funding agreements of $1.5 billion. The fair value of qualifying assets that were available to Prudential Insurance but not pledged amounted to $5.7 billion as of March 31, 2010.

As of March 31, 2010, $2.0 billion of the FHLBNY outstanding advances are reflected in Short-term debt with $1.0 billion maturing on June 4, 2010 and $1.0 billion maturing on December 6, 2010. The funding agreements issued to the FHLBNY, which are reflected in Policyholders account balances, have priority claim status above debt holders of Prudential Insurance.

**PRUDENTIAL FINANCIAL, INC.**

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

***Federal Home Loan Bank of Boston***

Prudential Retirement Insurance and Annuity Company, or PRIAC, became a member of the Federal Home Loan Bank of Boston or FHLBB, in December 2009. 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 March 31, 2010, 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, 2011. PRIAC must seek re-approval from CTDOI prior to borrowing additional funds after that date. Based on available eligible assets as of March 31, 2010, PRIAC had an estimated maximum borrowing capacity, after taking into consideration required collateralization levels and required purchases of activity based FHLBB stock, of approximately $1.1 billion.

***Term Asset-Backed Securities Loan Facility***

During 2009, the Company purchased securities under the Federal Reserve s Term Asset-Backed Securities Loan Facility ( TALF ). The TALF is designed to provide secured financing for the acquisition of certain types of asset-backed securities, including certain high-quality commercial mortgage-backed securities issued before January 1, 2009. TALF financing is non-recourse to the borrower, is collateralized by the purchased securities and provides financing for the purchase price of the securities, less a haircut that varies based on the type of collateral. Borrowers under the program can deliver the collateralized securities to a special purpose vehicle created by the Federal Reserve in full defeasance of the loan.

During 2009, the Company obtained $1,167 million of secured financing from the Federal Reserve under this program. In 2009, the Company sold a portion of the securities purchased under the program and used the proceeds to repay $738 million of the borrowings. In 2010, the Company sold a portion of the remaining securities purchased under the program and used the proceeds, as well as internal sources of cash, to repay the remaining $429 million of the borrowings.

**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. The Company has elected to amortize its transition obligation for other postretirement benefits over 20 years.

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**PRUDENTIAL FINANCIAL, INC.**

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

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

| | Three Months Ended March 31, | | | |
|---|---|---|---|---|
| | Pension Benefits | | Other Postretirement Benefits | |
| | 2010 | 2009 | 2010 | 2009 |
| | (in millions) | | | |
| **Components of net periodic (benefit) cost** | | | | |
| Service cost | $ 45 | $ 41 | $ 3 | $ 3 |
| Interest cost | 117 | 115 | 28 | 29 |
| Expected return on plan assets | (186) | (182) | (27) | (27) |
| Amortization of prior service cost | 6 | 7 | (3) | (3) |
| Amortization of actuarial (gain) loss, net | 10 | 8 | 10 | 11 |
| Special termination benefits | 1 | | | |
| Net periodic (benefit) cost | $ (7) | $ (11) | $ 11 | $ 13 |

The Company has evaluated the impact of the Patient Protection and Affordable Care Act ( PPACA ) and Health Care and Education Reconciliation Act ( HCERA ) signed into law in March 2010 on its Retiree Medical obligations and has concluded the impact is not material. The effects of the Acts will be included in the next measurement of the obligation at December 31, 2010.

**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 seven reportable segments. The Company s real estate and relocation services business, as well as businesses that are not sufficiently material to warrant separate disclosure and 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 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 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;

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**PRUDENTIAL FINANCIAL, INC.**

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

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

- equity in earnings of operating joint ventures 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.

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

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

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

Gains and losses pertaining to derivative contracts that do not qualify for hedge accounting treatment, other than derivatives used in the Company s capacity as a broker or dealer, are included in Realized investment gains

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**PRUDENTIAL FINANCIAL, INC.**

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

(losses), net. This includes mark-to-market adjustments of open contracts as well as periodic settlements. As discussed further below, adjusted operating income includes a portion of realized gains and losses pertaining to certain derivative contracts.

Adjusted operating income of the International Insurance segment and International Investments segment, excluding the global commodities group, reflect the impact of an intercompany arrangement with Corporate and Other operations pursuant to which the segments non-U.S. dollar denominated earnings in all countries for a particular year, including its interim reporting periods, are translated at fixed currency exchange rates. The fixed rates are determined in connection with a currency hedging program designed to mitigate the risk that unfavorable rate changes will reduce the segments U.S. dollar equivalent earnings. Pursuant to this program, the Company s Corporate and Other operations execute forward currency contracts with third parties to sell the 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 and, as noted above, all resulting profits or losses from such contracts are included in Realized investment gains (losses), net. When the contracts are terminated in the same period that the expected earnings emerge, the resulting positive or negative cash flow effect is included in adjusted operating income (net losses of $19 million and $3 million for the three months ended March 31, 2010 and 2009, respectively). As of March 31, 2010 and December 31, 2009, the fair value of open contracts used for this purpose was a net asset of $1 million and a net liability of $16 million, respectively.

The Company uses interest rate and currency swaps and other derivatives to manage interest and currency exchange rate exposures arising from mismatches between assets and liabilities, including duration mismatches. For the derivative contracts that do not qualify for hedge accounting treatment, mark-to-market adjustments of open contracts as well as periodic settlements are included in Realized investment gains (losses), net. However, the periodic swap settlements, as well as other derivative related yield adjustments, are included in adjusted operating income to reflect the after-hedge yield of the underlying instruments. In certain instances, when these derivative contracts are terminated or offset before their final maturity, the resulting realized gains or losses recorded within Realized investment gains (losses), net 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. Adjusted operating income includes net gains of $70 million and $26 million for the three months ended March 31, 2010 and 2009, respectively, due to periodic settlements and yield adjustments of such contracts, and includes net gains of $7 million and $6 million for the three months ended March 31, 2010 and 2009, respectively, related to derivative contracts that were terminated or offset in prior periods. The table below reflects the total deferred gain (loss) as of March 31, 2010, related to derivative contracts that were terminated or offset in prior periods that will be recognized in adjusted operating income in future periods for each segment, as well as the weighted average period over which these deferred amounts will be recognized.

| | Deferred Amount (in millions) | Weighted Average Period |
|---|---|---|
| **Segment:** | | |
| International Insurance | $ 742 | 30 years |
| Asset Management | 30 | 10 years |
| Corporate and Other | (55) | 7 years |
| Total deferred gain (loss) | $ 717 | |

**PRUDENTIAL FINANCIAL, INC.**

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

Certain products the Company sells are accounted for as freestanding derivatives or contain embedded derivatives. Changes in the fair value of these derivatives, along with any fees received or payments made relating to the derivative, are recorded in Realized investment gains (losses), net. These Realized investment gains (losses), net are included in adjusted operating income in the period in which the gain or loss is recorded. In addition, the changes in fair value of any associated derivative portfolio that is part of an economic hedging program related to the risk of these products (but which do not qualify for hedge accounting treatment under U.S. GAAP) are also included in adjusted operating income in the period in which the gains or losses on the derivative portfolio are recorded. Adjusted operating income includes net gains of $117 million and $1,345 million for the three months ended March 31, 2010 and 2009, respectively, related to these products and any associated derivative portfolio.

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

The Company conducts certain activities for which Realized investment gains (losses), net are a principal source of earnings for its businesses and therefore included in adjusted operating income, particularly within the Company s Asset Management segment. For example, Asset Management s proprietary investing business makes investments for sale or syndication to other investors or for placement or co-investment in the Company s managed funds and structured products. The Realized investment gains (losses), net associated with the sale of these proprietary investments, 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 (losses), net 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. Net realized investment losses of $21 million and $50 million for the three months ended March 31, 2010 and 2009, respectively, related to these and other businesses were included in adjusted operating income as an adjustment to Realized investment gains (losses), net.

The Company has certain investments 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, and interest and dividend income for these investments is recorded in Net investment income. Consistent with the exclusion of realized investment gains and losses with respect to other investments managed on a consistent basis, the net gains or losses on these investments, which is recorded within Asset management fees and other income, is excluded from adjusted operating income and is reflected as an adjustment to Realized investment gains (losses), net. In addition, prior to the Company s repayment of the obligation in 2010, the secured financing received from the Federal Reserve under TALF was reflected within Long-term debt, and carried at fair value under the fair value option under authoritative guidance around fair value. The changes in the fair value of this debt, which were recorded within Asset management fees and other income, was also excluded from adjusted operating income and reflected as an adjustment to Realized investment gains (losses), net. This is consistent with the securities purchased with the proceeds from this financing, which were carried at fair value and included in Other trading account assets, at fair value as discussed above. The net impact of these adjustments was to exclude from adjusted operating income net gains of $39 million and net losses of $40 million, for the three months ended March 31, 2010 and 2009, respectively.

The Company has certain assets and liabilities for which, under GAAP, the change in value due to changes in foreign currency exchange rates during the period is recorded in Asset management fees and other income. To the extent the foreign currency exposure on these assets and liabilities is economically hedged, the change in value included in Asset management fees and other income is excluded from adjusted operating income and is

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**PRUDENTIAL FINANCIAL, INC.**

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

reflected as an adjustment to Realized investment gains (losses), net. The net impact of these adjustments was to exclude from adjusted operating income net losses of $62 million, and net gains of $78 million for the three months ended March 31, 2010 and 2009, respectively.

*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 investments supporting these experience-rated products, excluding commercial mortgage and other loans, are classified as trading and are carried at fair value. These trading investments are reflected on the statements of financial position as Trading account assets supporting insurance liabilities, at fair value. Realized and unrealized gains and losses for these investments are reported in Asset management fees and other income. Interest and dividend income for these investments is reported in Net investment income. Commercial 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.

Adjusted operating income excludes net investment gains and losses on trading account assets supporting insurance liabilities. This is consistent with the exclusion of realized investment gains and losses with respect to other investments supporting insurance liabilities managed on a consistent basis. In addition, to be consistent with the historical treatment of charges related to realized investment gains and losses on 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 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, but that did not qualify for discontinued operations accounting treatment under U.S. GAAP, are excluded from adjusted operating income as the results of divested businesses are not relevant to understanding the Company s ongoing operating results.

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

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

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**PRUDENTIAL FINANCIAL, INC.**

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

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

| | Three Months Ended March 31, 2010 | 2009 |
|---|---|---|
| | (in millions) | |
| Adjusted Operating Income before income taxes for Financial Services Businesses by Segment: | | |
| Individual Annuities | $ 260 | $ 17 |
| Retirement | 171 | 159 |
| Asset Management | 83 | (1) |
| Total U.S. Retirement Solutions and Investment Management Division | 514 | 175 |
| Individual Life | 91 | 40 |
| Group Insurance | 53 | 93 |
| Total U.S. Individual Life and Group Insurance Division | 144 | 133 |
| International Insurance | 484 | 425 |
| International Investments | 12 | 7 |
| Total International Insurance and Investments Division | 496 | 432 |
| Corporate Operations | (195) | (112) |
| Real Estate and Relocation Services | (7) | (63) |
| Total Corporate and Other | (202) | (175) |
| Adjusted Operating Income before income taxes for Financial Services Businesses | 952 | 565 |
| Reconciling items: | | |
| Realized investment gains (losses), net, and related adjustments | (55) | (707) |
| Charges related to realized investment gains (losses), net | (29) | 44 |
| Investment gains (losses) on trading account assets supporting insurance liabilities, net | 252 | 145 |
| Change in experience-rated contractholder liabilities due to asset value changes | (320) | (45) |
| Divested businesses | (7) | (32) |
| Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests | (36) | 3 |
| Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures for Financial Services Businesses | 757 | (27) |
| Income from continuing operations before income taxes and equity in earnings of operating joint ventures for Closed Block Business | 259 | 30 |
| | $ 1,016 | $ 3 |

| Income from continuing operations before income taxes and equity in earnings of operating joint ventures |
| --- |

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.

**PRUDENTIAL FINANCIAL, INC.**

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

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2010 | 2009 |
| | (in millions) | |
| Financial Services Businesses: | | |
| Individual Annuities | $ 873 | $ 1,892 |
| Retirement | 1,132 | 1,208 |
| Asset Management | 379 | 263 |
| Total U.S. Retirement Solutions and Investment Management Division | 2,384 | 3,363 |
| Individual Life | 687 | 680 |
| Group Insurance | 1,311 | 1,333 |
| Total U.S. Individual Life and Group Insurance Division | 1,998 | 2,013 |
| International Insurance | 2,913 | 2,537 |
| International Investments | 81 | 75 |
| Total International Insurance and Investments Division | 2,994 | 2,612 |
| Corporate Operations | (62) | (18) |
| Real Estate and Relocation Services | 41 | (3) |
| Total Corporate and Other | (21) | (21) |
| Total | 7,355 | 7,967 |
| Reconciling items: | | |
| Realized investment gains (losses), net, and related adjustments | (55) | (707) |
| Charges related to realized investment gains (losses), net | (44) | (8) |
| Investment gains (losses) on trading account assets supporting insurance liabilities, net | 252 | 145 |
| Divested businesses | 2 | (26) |
| Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests | (10) | 14 |
| Total Financial Services Businesses | 7,500 | 7,385 |
| Closed Block Business | 1,792 | 1,140 |
| Total per Unaudited Interim Consolidated Financial Statements | $ 9,292 | $ 8,525 |

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2010 | 2009 |
| | (in millions) | |
| Asset Management segment intersegment revenues | $ 90 | $ 85 |

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

**PRUDENTIAL FINANCIAL, INC.**

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

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

| | March 31, 2010 | December 31, 2009 |
|---|---|---|
| | (in millions) | |
| Individual Annuities | $ 89,158 | $ 84,064 |
| Retirement | 125,866 | 123,625 |
| Asset Management | 30,161 | 30,185 |
| Total U.S. Retirement Solutions and Investment Management Division | 245,185 | 237,874 |
| Individual Life | 38,893 | 36,917 |
| Group Insurance | 33,964 | 32,935 |
| Total U.S. Individual Life and Group Insurance Division | 72,857 | 69,852 |
| International Insurance | 88,312 | 87,590 |
| International Investments | 5,175 | 4,997 |
| Total International Insurance and Investments Division | 93,487 | 92,587 |
| Corporate Operations | 13,823 | 14,368 |
| Real Estate and Relocation Services | 566 | 590 |
| Total Corporate and Other | 14,389 | 14,958 |
| Total Financial Services Businesses | 425,918 | 415,271 |
| Closed Block Business | 65,943 | 64,932 |
| Total | $ 491,861 | $ 480,203 |

**12. INCOME TAXES**

The Company s liability for income taxes includes the liability for unrecognized tax benefits, interest and penalties which relate to tax years still subject to review by the Internal Revenue Service ( IRS ) or other taxing authorities. Audit periods remain open for review until the statute of limitations has passed. Generally, for tax years which produce net operating losses, capital losses or tax credit carryforwards ( tax attributes ), the statute of limitations does not close, to the extent of these tax attributes, until the expiration of the statute of limitations for the tax year in which they are fully utilized. The completion of review or the expiration of the statute of limitations for a given audit period could result in an adjustment to the liability for income taxes. The statute of limitations for the 2002 tax year expired on April 30, 2009. The statute of limitations for the 2003 tax year expired on July 31, 2009. The statute of limitations for the 2004, 2005, and 2006 tax years is set to expire in April 2011.

Tax years 2007 through 2009 are still open for IRS examination. The Company does not anticipate any significant changes within the next 12 months to its total unrecognized tax benefits related to tax years for which the statute of limitations has not expired.

The dividends received deduction ( DRD ) reduces the amount of dividend income subject to U.S. tax and is a significant component of the difference between the Company s effective tax rate and the federal statutory tax rate of 35%. The DRD for the current period was estimated using information from 2009, 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.

**PRUDENTIAL FINANCIAL, INC.**

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

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 regulations 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 1, 2010, the Obama Administration released the General Explanations of the Administration s Revenue Proposals. Although the Administration has not released proposed statutory language, 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 regulation or legislation, could increase actual tax expense and reduce the Company s consolidated net income. These activities had no impact on the Company s 2009 or first quarter 2010 results.

In December 2006, the IRS completed all fieldwork with respect to its examination of the consolidated federal income tax returns for tax years 2002 and 2003. The final report was initially submitted to the Joint Committee on Taxation for their review in April 2007. The final report was resubmitted in March 2008 and again in April 2008. The Joint Committee returned the report to the IRS for additional review of an industry issue regarding the methodology for calculating the DRD related to variable life insurance and annuity contracts. The IRS completed its review of the issue and proposed an adjustment with respect to the calculation of the DRD. In order to expedite receipt of an income tax refund related to the 2002 and 2003 tax years, the Company agreed to such adjustment. The report, with the adjustment to the DRD, was submitted to the Joint Committee on Taxation in October 2008. The Company was advised on January 2, 2009 that the Joint Committee completed its consideration of the report and took no exception to the conclusions reached by the IRS. Accordingly, the final report was processed and a $157 million refund was received in February 2009. The Company believes that its return position with respect to the calculation of the DRD is technically correct. Therefore, the Company filed protective refund claims on October 1, 2009 to recover the taxes associated with the agreed upon adjustment and to pursue such other actions as appropriate. These activities had no impact on the Company s 2009 or first quarter 2010 results.

In January 2007, the IRS began an examination of tax years 2004 through 2006. For tax years 2007, 2008 and 2009, the Company participated 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.

The Company s affiliates in Japan file separate tax returns and are subject to audits by the local taxing authority. The general statute of limitations is five years from when the return is filed. During 2009, the Tokyo Regional Taxation Bureau concluded a routine tax audit of the tax returns of Prudential Life Insurance Company Ltd. for its tax years ending March 31, 2004 to March 31, 2008. These activities had no material impact on the Company s 2009 or first quarter 2010 results.

The Company s affiliates in Korea file separate tax returns and are subject to audits by the local taxing authority. The general statute of limitations is five years from when the return is filed. During 2009, a local district office in the Korean tax authority concluded a routine tax audit of the local taxes for tax years ending March 31, 2004 through March 31, 2007 of Prudential Life Insurance Company of Korea, Ltd. These activities had no material impact on the Company s 2009 or first quarter 2010 results.

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**PRUDENTIAL FINANCIAL, INC.**

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

On March 23, 2010, President Obama signed into law the Patient Protection and Affordable Care Act, which was modified by the Health Care and Education Reconciliation Act of 2010 signed into law on March 30, 2010, (together, the Healthcare Act ). The federal government provides a subsidy to companies that provide certain retiree prescription drug benefits (the Medicare Part D subsidy ), including the Company. The Medicare Part D subsidy was previously provided tax-free. However, as currently adopted, the Healthcare Act includes a provision that would reduce the tax deductibility of retiree health care costs to the extent of any Medicare Part D subsidy received. In effect, this provision of the Healthcare Act makes the Medicare Part D subsidy taxable beginning in 2013. Therefore, the Company has incurred a charge in the first quarter of 2010 for the reduction of deferred tax assets of $94 million, which reduces net income and is reflected in Income tax expense (benefit).

**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 established a framework for measuring fair value that includes a hierarchy used to classify the inputs used in measuring fair value. The hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three levels. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement. The levels of the fair value hierarchy are as follows:

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

Level 2 Fair value is based on significant inputs, other than Level 1 inputs, that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability through corroboration with observable market data. Level 2 inputs include quoted market prices in active markets for similar assets and liabilities, quoted market prices in markets that are not active for identical or similar assets or liabilities, and other market observable inputs. The Company s Level 2 assets and liabilities include: fixed maturities (corporate public and private bonds, most government securities, certain asset-backed and mortgage-backed securities, etc.), certain equity securities and commercial mortgage loans, short-term investments and certain cash equivalents (primarily commercial paper), and certain over-the-counter derivatives. Valuations are generally obtained from third party pricing services for identical or comparable assets or liabilities or through the use of valuation methodologies using observable market inputs. Prices from services are validated through comparison to trade data and internal estimates of current fair value, generally developed using market observable inputs and economic indicators.

Level 3 Fair value is based on at least one or more significant unobservable inputs for the asset or liability. These inputs reflect the Company s assumptions about the assumptions market participants would use in pricing the asset or liability. The Company s Level 3 assets and liabilities primarily include: asset-backed securities collateralized by sub-prime mortgages as discussed below, 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

**PRUDENTIAL FINANCIAL, INC.**

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

benefits. Prices are determined using valuation methodologies such as option pricing models, discounted cash flow models and other similar techniques. Non-binding broker quotes, which are utilized when pricing service information is not available, are reviewed for reasonableness based on the Company s understanding of the market, and are generally considered Level 3. Under certain conditions, based on its observations of transactions in active markets, the Company may conclude the prices received from independent third party pricing services or brokers are not reasonable or reflective of market activity. In those instances, the Company may choose to over-ride the third-party pricing information or quotes received and apply internally developed values to the related assets or liabilities. To the extent the internally developed valuations use significant unobservable inputs, they are classified as Level 3. As of March 31, 2010 and December 31, 2009 these over-rides on a net basis were not material.

**Inactive Markets** During 2009 and continuing through March 31, 2010, the Company observed that the volume and level of activity in the market for asset-backed securities collateralized by sub-prime mortgages remained at historically low levels. This stood in particular contrast to the markets for other structured products with similar cash flow and credit profiles, which experienced an increase in the level of activity beginning in the second quarter of 2009. The Company also observed significant implied relative liquidity risk premiums, yields, and weighting of worst case cash flows for asset-backed securities collateralized by sub-prime mortgages in comparison with our own estimates for such securities. In contrast, the liquidity of other spread-based asset classes, such as corporate bonds, high yield and consumer asset-backed securities, such as those collateralized by credit cards or autos, which were previously more correlated with sub-prime securities, improved beginning in the second quarter of 2009. Based on this information, the Company concluded as of June 30, 2009, and continuing through March 31, 2010, that the market for asset-backed securities collateralized by sub-prime mortgages was inactive and also determined the pricing quotes it received were based on limited market transactions, calling into question their representation of observable fair value.

Based on this conclusion, in determining the fair value of certain asset-backed securities collateralized by sub-prime mortgages, the Company considered both third-party pricing information, and an internally developed price, based on a discounted cash flow model. The discount rate used in the model was based on observed spreads for other similarly structured credit markets which were active and dominated by observable orderly transactions. The Company also applied additional risk premiums to the discount rate to reflect the relative illiquidity and asset specific cash flow uncertainty associated with asset-backed securities collateralized by sub-prime mortgages. This combined security specific additional spread reflects the Company s judgment of what an investor would demand for taking on such risks in an orderly transaction under current market conditions, and is significantly higher than would be indicative of historical spread differences between structured credit asset classes when all asset classes had active markets dominated with orderly transactions. The Company believes these estimated spreads are reflective of current market conditions in the sub-prime mortgage market and these spread estimates are further supported by their relationship to recent observations of limited transactions in sub-prime securities. Using this discount rate, valuations were developed based on the expected future cash flows of the assets. In determining how much weight to place on the third-party pricing information versus our discounted cash flow valuation, the Company considered the level of inactivity and the amount of observable information. As of March 31, 2010, the Company weighted third-party pricing information 75% for low rated categories where it had less observable market information and 100% for all other ratings where more observable information was available. As a result, as of March 31, 2010, the Company reported fair values for these asset-backed securities collateralized by sub-prime securities which were net $222 million higher than the estimated fair values received from independent third party pricing services or brokers. The adjusted fair value of these securities was $5,262 million, which was reflected within Level 3 in the fair value hierarchy as of March 31, 2010, based on the unobservable inputs used in the discounted cash flow model and the limited observable market activity.

**PRUDENTIAL FINANCIAL, INC.**

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

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

| | As of March 31, 2010 | | | | |
|---|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 (in millions) | Netting(2) | Total |
| Fixed maturities, available for sale: | | | | | |
| U.S. Treasury securities and obligations of U.S. government authorities and agencies | $ | $ 8,963 | $ | $ | $ 8,963 |
| Obligations of U.S. states and their political subdivisions | | 1,506 | | | 1,506 |
| Foreign government bonds | | 41,320 | 46 | | 41,366 |
| Corporate securities | 5 | 94,703 | 955 | | 95,663 |
| Asset-backed securities | | 4,081 | 6,023 | | 10,104 |
| Commercial mortgage-backed securities | | 11,440 | 245 | | 11,685 |
| Residential mortgage-backed securities | | 11,137 | 26 | | 11,163 |
| Sub-total | 5 | 173,150 | 7,295 | | 180,450 |
| Trading account assets supporting insurance liabilities: | | | | | |
| U.S. Treasury securities and obligations of U.S. government authorities and agencies | | 269 | | | 269 |
| Obligations of U.S. states and their political subdivisions | | 57 | | | 57 |
| Foreign government bonds | | 504 | | | 504 |
| Corporate securities | | 9,681 | 95 | | 9,776 |
| Asset-backed securities | | 710 | 277 | | 987 |
| Commercial mortgage-backed securities | | 1,889 | 48 | | 1,937 |
| Residential mortgage-backed securities | | 1,364 | 20 | | 1,384 |
| Equity securities | 769 | 244 | 4 | | 1,017 |
| Short-term investments and cash equivalents | 441 | 311 | | | 752 |
| Sub-total | 1,210 | 15,029 | 444 | | 16,683 |
| Other trading account assets: | | | | | |
| U.S. Treasury securities and obligations of U.S. government authorities and agencies | | 323 | | | 323 |
| Obligations of U.S. states and their political subdivisions | | | | | |
| Foreign government bonds | | 23 | | | 23 |
| Corporate securities | 14 | 284 | 36 | | 334 |
| Asset-backed securities | | 633 | 54 | | 687 |
| Commercial mortgage-backed securities | | 98 | 22 | | 120 |
| Residential mortgage-backed securities | | 163 | 20 | | 183 |
| Equity securities | 323 | 138 | 25 | | 486 |
| All other activity | 107 | 4,974 | 185 | (4,051) | 1,215 |
| Sub-total | 444 | 6,636 | 342 | (4,051) | 3,371 |
| Equity securities, available for sale | 4,242 | 2,491 | 355 | | 7,088 |
| Commercial mortgage and other loans | | | 331 | | 331 |
| Other long-term investments | 43 | 9 | 478 | | 530 |
| Short-term investments | 3,327 | 3,248 | | | 6,575 |

| | | | | | |
|---|---|---|---|---|---|
| Cash equivalents | 2,021 | 5,143 | | | 7,164 |
| Other assets | 2,290 | 81 | 20 | | 2,391 |
| Sub-total excluding separate account assets | 13,582 | 205,787 | 9,265 | (4,051) | 224,583 |
| Separate account assets(1) | 93,075 | 76,906 | 12,640 | | 182,621 |
| Total assets | $ 106,657 | $ 282,693 | $ 21,905 | $ (4,051) | $ 407,204 |
| Future policy benefits | | | (166) | | (166) |
| Long-term debt | | | | | |
| Other liabilities | 25 | 4,506 | 2 | (3,891) | 642 |
| Total liabilities | $ 25 | $ 4,506 | $ (164) | $ (3,891) | $ 476 |

**PRUDENTIAL FINANCIAL, INC.**

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

| | As of December 31, 2009 | | | | |
|---|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 (in millions) | Netting(2) | Total |
| Fixed maturities, available for sale: | | | | | |
| U.S. Treasury securities and obligations of U.S. government authorities and agencies | $ | $ 8,268 | $ | $ | $ 8,268 |
| Obligations of U.S. states and their political subdivisions | | 1,375 | | | 1,375 |
| Foreign government bonds | | 41,162 | 47 | | 41,209 |
| Corporate securities | 5 | 90,639 | 902 | | 91,546 |
| Asset-backed securities | | 3,875 | 6,363 | | 10,238 |
| Commercial mortgage-backed securities | | 10,713 | 305 | | 11,018 |
| Residential mortgage-backed securities | | 11,467 | 104 | | 11,571 |
| Sub-total | 5 | 167,499 | 7,721 | | 175,225 |
| Trading account assets supporting insurance liabilities: | | | | | |
| U.S. Treasury securities and obligations of U.S. government authorities and agencies | | 128 | | | 128 |
| Obligations of U.S. states and their political subdivisions | | 31 | | | 31 |
| Foreign government bonds | | 517 | | | 517 |
| Corporate securities | | 9,419 | 83 | | 9,502 |
| Asset-backed securities | | 576 | 281 | | 857 |
| Commercial mortgage-backed securities | | 1,888 | 5 | | 1,893 |
| Residential mortgage-backed securities | | 1,412 | 20 | | 1,432 |
| Equity securities | 700 | 232 | 3 | | 935 |
| Short-term investments and cash equivalents | 338 | 387 | | | 725 |
| Sub-total | 1,038 | 14,590 | 392 | | 16,020 |
| Other trading account assets: | | | | | |
| U.S. Treasury securities and obligations of U.S. government authorities and agencies | | 95 | | | 95 |
| Obligations of U.S. states and their political subdivisions | | | | | |
| Foreign government bonds | | 24 | | | 24 |
| Corporate securities | 15 | 310 | 34 | | 359 |
| Asset-backed securities | | 894 | 97 | | 991 |
| Commercial mortgage-backed securities | | 109 | 27 | | 136 |
| Residential mortgage-backed securities | | 146 | 12 | | 158 |
| Equity securities | 311 | 136 | 24 | | 471 |
| All other activity | 13 | 4,731 | 297 | (4,242) | 799 |
| Sub-total | 339 | 6,445 | 491 | (4,242) | 3,033 |
| Equity securities, available for sale | 4,008 | 2,494 | 393 | | 6,895 |
| Commercial mortgage and other loans | | 114 | 338 | | 452 |
| Other long-term investments | 36 | 66 | 498 | | 600 |
| Short-term investments | 3,561 | 2,831 | | | 6,392 |
| Cash equivalents | 5,671 | 4,468 | | | 10,139 |
| Other assets | 2,391 | 176 | 27 | | 2,594 |
| Sub-total excluding separate account assets | 17,049 | 198,683 | 9,860 | (4,242) | 221,350 |
| Separate account assets(1) | 88,888 | 72,292 | 12,894 | | 174,074 |

| | | | | | |
|---|---|---|---|---|---|
| Total assets | $ 105,937 | $ 270,975 | $ 22,754 | $ (4,242) | $ 395,424 |
| Future policy benefits | | | 55 | | 55 |
| Long-term debt | | | 429 | | 429 |
| Other liabilities | | 4,764 | 6 | (3,841) | 929 |
| Total liabilities | $ | $ 4,764 | $ 490 | $ (3,841) | $ 1,413 |

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**PRUDENTIAL FINANCIAL, INC.**

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

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

The methods and assumptions the Company uses to estimate fair value of assets and liabilities measured at fair value on a recurring basis are summarized below. Information regarding Separate Account Assets is excluded as the risk of assets for these categories is ultimately borne by our customers and policyholders.

**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. To validate reasonability, prices are reviewed by internal asset managers through comparison with directly observed recent market trades and internal estimates of current fair value, developed using market observable inputs and economic indicators. 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 in comparison to the presented market observations, the security remains within Level 2.

If the Company ultimately concludes that pricing information received from the independent pricing service is not reflective of market activity, non-binding broker quotes are used, if available. 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 March 31, 2010 and December 31, 2009 over-rides on a net basis were not material. Internally developed valuations or non-binding broker quotes are also used to determine fair value in circumstances where vendor pricing is not available. These estimates may use significant unobservable inputs, which reflect our own assumptions about the inputs market participants would use in pricing the asset. Circumstances where observable market data are not available may include events such as market illiquidity and credit events related to the security. Pricing service over-rides, internally developed valuations and non-binding broker quotes are generally included in Level 3 in our fair value hierarchy.

The fair value of private fixed maturities, which are primarily comprised of investments in private placement securities, originated by internal private asset managers, are primarily determined using a discounted cash flow model. In certain cases these models primarily use observable inputs with a discount rate based upon the average of spread surveys collected from private market intermediaries who are active in both primary and secondary transactions, taking into account, among other factors, the credit quality and industry sector of the issuer and the reduced liquidity associated with private placements. Generally, these 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. Accordingly, these securities have been reflected within Level 3. Significant unobservable inputs used include: issue specific credit adjustments, material non-public financial information, management judgment, estimation of future earnings and cash flows, default rate assumptions, and liquidity assumptions. These inputs are usually considered

unobservable, as not all market participants will have access to this data.

**PRUDENTIAL FINANCIAL, INC.**

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

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.

**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. Other trading account assets also include certain assets originally purchased under TALF, as described below under Long-Term Debt.

**Equity Securities** Consist principally of investments in common and preferred stock of publicly traded companies, privately traded securities, as well as common stock 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. In determining the fair value of certain privately traded equity securities the discounted cash flow model may also use unobservable inputs, which reflect the Company s assumptions about the inputs market participants would use in pricing the asset. Most privately traded equity securities are classified within Level 3. The fair values of common stock 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 preferred equity securities are based on prices obtained from independent pricing services and, in order to validate reasonability, are compared with directly observed recent market trades. Accordingly, these securities are generally classified within Level 2 in the fair value hierarchy.

**Commercial Mortgage and Other Loans** The fair value of commercial mortgage loans held for investment and accounted for using the Fair Value Option are determined based on the present value of the expected future cash flows discounted at the appropriate U.S. Treasury rate, adjusted for the current market spread for similar quality loans. While the interest rate and market spread assumptions for similar quality loans are generally observable based upon market transactions, downward credit migration of these loans has resulted in the use of higher credit spreads, which are internally developed and not observable in the market place. As a result, these loans are included in Level 3 in the fair value hierarchy. The fair value of loans held for sale and accounted for using the Fair Value Option are determined utilizing pricing indicators from the whole loan markets, which are considered the principal exit markets for these loans. The Company has evaluated the valuation inputs used for these assets, including 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** 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 and equity securities), as well as wholly-owned real estate held within other investment funds. The fair value of the feeder fund investments in master funds are generally determined by reference to the investments in the underlying master funds.

**PRUDENTIAL FINANCIAL, INC.**

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

The fair value of investments in funds holding publicly traded equity securities are generally based on quoted prices in active markets for identical investments and are therefore reflected as Level 1. The fair value of investments in funds holding public fixed maturities are generally based on validated quotes from pricing services or observable data as described above, and are reflected in Level 2. The fair value of investments in funds holding public fixed maturities that are subject to significant liquidity restrictions are reflected in Level 3.

The fair value of real estate held in consolidated investment funds is determined through an independent appraisal process. The appraisals generally utilize a discounted cash flow model, following an income approach that incorporates various assumptions including rental revenue, operating expenses and discount rates. 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, and incorporate historical property experience and any observable market data, including any market transactions. Since many of the assumptions utilized are unobservable and are considered to be significant inputs to the valuation, the real estate investments within other long-term investments have been reflected within Level 3 in the fair value hierarchy.

**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 and liquidity as well as 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. Fair values can also be affected by changes in estimates and assumptions including those related to counterparty behavior used in valuation models.

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 our fair value hierarchy.

The majority of the Company s derivative positions are traded in the over-the-counter (OTC) derivative market and are classified within Level 2 in the fair value hierarchy. OTC derivatives classified within Level 2 are valued using models generally accepted in the financial services industry that use actively quoted or observable market input values from external market data providers, non-binding broker-dealer quotations, third-party pricing vendors and/or recent trading activity. 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 assumptions 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 and volatility.

OTC derivative contracts are executed under master netting agreements with counterparties with a Credit Support Annex, or CSA, which is a bilateral ratings-sensitive agreement that requires collateral postings at established credit threshold levels. These agreements protect the interests of the Company and its counterparties, should either party suffer a credit rating deterioration. 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

**PRUDENTIAL FINANCIAL, INC.**

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

Offered Rate ( LIBOR ) into the discount rate used in determining the fair value of OTC derivative assets and liabilities. However, the non-performance risk adjustment is applied only to the uncollateralized portion of the OTC derivative assets and liabilities, after consideration of the impacts of two-way collateral posting. Most OTC derivative contracts have bid and ask prices that are actively quoted or can be readily obtained from external market data providers. The Company s policy is to use mid-market pricing in determining its best estimate of fair value.

Level 3 includes OTC derivatives where the bid-ask spreads are generally wider than derivatives classified within Level 2 thus requiring more judgment in estimating the mid-market price of such derivatives. 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 such as: individual credit default spreads, interest rates, 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 technique. The input values for look-back equity options are derived from observable market indices such as interest rates, dividend yields, equity indices as well as unobservable model-specific input values such as certain volatility parameters. Level 3 methodologies are validated through periodic comparison of the Company s fair values to broker-dealer values.

**Cash Equivalents and Short-Term Investments** Include money market instruments, commercial paper and other highly liquid debt instruments. Money market instruments are generally 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 based on market observable inputs and, accordingly, these investments have been classified within Level 2 in the fair value hierarchy.

**Other Assets and Other Liabilities** Other assets carried at fair value include U.S. Treasury bills held within our global commodities group whose fair values are determined consistent with similar securities described above under Fixed Maturity Securities. Included in other liabilities are various derivatives contracts executed within our global commodities group, including exchange-traded futures, foreign currency and commodity contracts. The fair values of these derivative instruments are determined consistent with similar derivative instruments described above under Derivative Instruments.

**Future Policy Benefits** The liability for future policy benefits 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. 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 Company is also required to incorporate its own risk of non-performance in the valuation 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

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**PRUDENTIAL FINANCIAL, INC.**

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

in the valuation of the liability appropriately takes into consideration the Company s own risk of non-performance. Historically, the expected cash flows were discounted using forward LIBOR interest rates, which were commonly viewed as being consistent with AA quality financial strength ratings. However, in light of first quarter of 2009 developments, including rating agency downgrades to the financial strength ratings of the Company s insurance subsidiaries, the Company determined that forward LIBOR interest rates were no longer indicative of a market participant s view of the Company s financial strength. As a result, beginning in the first quarter of 2009, to reflect the market s perception of its non-performance risk, the Company incorporated an additional spread over LIBOR into the discount rate used in the valuations of the embedded derivatives associated with its optional living benefit features, thereby increasing the discount rate and reducing the fair value of the embedded derivative liabilities. 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 liquidity risk premium. The additional spread over LIBOR incorporated into the discount rate as of March 31, 2010 generally ranged from 75 to 150 basis points for the portion of the interest rate curve most relevant to these liabilities.

Other 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, as well as various policyholder behavior assumptions that are actuarially determined, including lapse rates, benefit utilization rates, mortality rates and withdrawal rates. These assumptions are reviewed at least annually, and updated based upon historical experience and give consideration to any observable market data, including market transactions such as acquisitions and reinsurance transactions. Since many of the assumptions utilized in the valuation of the embedded derivatives associated with the Company s optional living benefit features 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.

**Long-Term Debt** Included funding received from the Federal Reserve Bank of New York on a non-recourse basis to finance the purchase of eligible asset-backed securities, under TALF, as of December 31, 2009. The Company valued these liabilities using various inputs including the value of the collateral (eligible asset-backed securities), a comparison of the liabilities spread over LIBOR to the spreads in current TALF offerings and various other market observable and non-observable inputs which incorporated significant management judgment. As a result, the pricing of the non-recourse liabilities were classified within Level 3 in the Company s fair value hierarchy. The pricing of the collateral assets (recorded in other trading account assets ) was generally based on third party pricing information as discussed above, and included in Level 2 in the Company s fair value hierarchy. See Note 9 for additional information regarding the Company s participation in TALF.

**Transfers between Levels 1 and 2** During the three months ended March 31, 2010, $2.9 billion of Separate Account assets transferred from Level 2 to Level 1. The assets that transferred were foreign common stocks. This transfer was the result of no adjustment being made at March 31, 2010 for the fair value of these assets beyond the quoted market price. At December 31, 2009 an adjustment was made to the quoted market prices of these types of assets to reflect events that occurred after foreign trading markets closed and prior to the close of U.S. trading markets on that day.

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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 a summary of the changes in fair value of Level 3 assets and liabilities for the three months ended March 31, 2010, as well as the portion of gains or losses included in income for the three months ended March 31, 2010 attributable to unrealized gains or losses related to those assets and liabilities still held at March 31, 2010.

| | Three Months Ended March 31, 2010 | | | | |
|---|---|---|---|---|---|
| | Fixed Maturities Available For Sale-Foreign Government Bonds | Fixed Maturities Available For Sale-Corporate Securities | Fixed Maturities Available For Sale Asset-Backed Securities | Fixed Maturities Available For Sale-Commercial Mortgage-Backed Securities | Fixed Maturities Available For Sale-Residential Mortgage-Backed Securities |
| | (in millions) | | | | |
| Fair Value, beginning of period | $ 47 | $ 902 | $ 6,363 | $ 305 | $ 104 |
| Total gains or (losses) (realized/unrealized): | | | | | |
| Included in earnings: | | | | | |
| Realized investment gains (losses), net | | (16) | (60) | (114) | |
| Asset management fees and other income | | | | | |
| Included in other comprehensive income (loss) | | 36 | 92 | 40 | |
| Net investment income | | 7 | (36) | | |
| Purchases, sales, issuances and settlements | | (21) | (311) | 2 | (2) |
| Foreign currency translation | | (1) | (5) | (7) | |
| Other(1) | | | (8) | 56 | (48) |
| Transfers into Level 3(2) | | 66 | | 11 | 2 |
| Transfers out of Level 3(2) | (1) | (18) | (12) | (48) | (30) |
| Fair Value, end of period | $ 46 | $ 955 | $ 6,023 | $ 245 | $ 26 |
| Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(3): | | | | | |
| Included in earnings: | | | | | |
| Realized investment gains (losses), net | $ | $ (14) | $ (74) | $ (114) | $ |
| Asset management fees and other income | $ | $ | $ | $ | $ |
| Included in other comprehensive income (loss) | $ | $ 37 | $ 73 | $ 40 | $ |

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**PRUDENTIAL FINANCIAL, INC.**

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

| | Three Months Ended March 31, 2010 | | | |
|---|---|---|---|---|
| | Trading Account Assets Supporting Insurance Liabilities-Corporate Securities | Trading Account Assets Supporting Insurance Liabilities-Asset Backed Securities | Trading Account Assets Supporting Insurance Liabilities-Commercial Mortgage-Backed Securities | Trading Account Assets Supporting Insurance Liabilities-Residential Mortgage-Backed Securities |
| | (in millions) | | | |
| Fair Value, beginning of period | $ 83 | $ 281 | $ 5 | $ 20 |
| Total gains or (losses) (realized/unrealized): | | | | |
| Included in earnings: | | | | |
| Realized investment gains (losses), net | (4) | (2) | | |
| Asset management fees and other income | 4 | (2) | 4 | |
| Included in other comprehensive income (loss) | | | | |
| Net investment income | 1 | | | |
| Purchases, sales, issuances and settlements | (7) | 16 | (1) | |
| Other(1) | | (9) | 9 | |
| Transfers into Level 3(2) | 18 | | 31 | |
| Transfers out of Level 3(2) | | (7) | | |
| Fair Value, end of period | $ 95 | $ 277 | $ 48 | $ 20 |
| Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(3): | | | | |
| Included in earnings: | | | | |
| Realized investment gains (losses), net | $ | $ | $ | $ |
| Asset management fees and other income | $ (1) | $ (3) | $ 4 | $ |
| Included in other comprehensive income (loss) | $ | $ | $ | $ |

| | Three Months Ended March 31, 2010 | | | | |
|---|---|---|---|---|---|
| | Trading Account Assets Supporting Insurance Liabilities-Equity Securities | Other Trading Account Assets-Corporate Securities | Other Trading Account Assets-Asset-Backed Securities | Other Trading Account Assets-Commercial Mortgage-Backed Securities | Other Trading Account Assets-Residential Mortgage-Backed Securities |
| | (in millions) | | | | |
| Fair Value, beginning of period | $ 3 | $ 34 | $ 97 | $ 27 | $ 12 |
| Total gains or (losses) (realized/unrealized): | | | | | |
| Included in earnings: | | | | | |
| Realized investment gains (losses), net | | | | | |
| Asset management fees and other income | 1 | | | | 2 |
| Included in other comprehensive income (loss) | | | | | |
| Net investment income | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| Purchases, sales, issuances and settlements | | 1 | (42) | | |
| Foreign currency translation | | | (1) | | |
| Transfers into Level 3(2) | | 1 | 2 | 1 | 7 |
| Transfers out of Level 3(2) | | | (2) | (6) | (1) |
| Fair Value, end of period | $ 4 | $ 36 | $ 54 | $ 22 | $ 20 |
| Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(3): | | | | | |
| Included in earnings: | | | | | |
| Realized investment gains (losses), net | $ | $ | $ | $ | $ |
| Asset management fees and other income | $ 1 | $ | $ (1) | $ (1) | $ 2 |
| Included in other comprehensive income (loss) | $ | $ | $ | $ | $ |

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**PRUDENTIAL FINANCIAL, INC.**

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

| | Three Months Ended March 31, 2010 | | | | |
|---|---|---|---|---|---|
| | Other Trading Account Assets-Equity Securities | Other Trading Account Assets-All Other Activity | Equity Securities Available for Sale | Commercial Mortgage and Other Loans | Other Long-term Investments |
| | | | (in millions) | | |
| Fair Value, beginning of period | $ 24 | $ 297 | $ 393 | $ 338 | $ 498 |
| Total gains or (losses) (realized/unrealized): | | | | | |
| Included in earnings: | | | | | |
| Realized investment gains (losses), net | | (41) | 15 | (7) | (5) |
| Asset management fees and other income | | 4 | | | (16) |
| Included in other comprehensive income (loss) | | | (7) | | |
| Net investment income | | | | | 2 |
| Purchases, sales, issuances and settlements | 2 | (75) | (42) | | (1) |
| Foreign currency translation | (1) | | (6) | | |
| Transfers into Level 3(2) | | | 2 | | |
| Transfers out of Level 3(2) | | | | | |
| Fair Value, end of period | $ 25 | $ 185 | $ 355 | $ 331 | $ 478 |
| Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(3): | | | | | |
| Included in earnings: | | | | | |
| Realized investment gains (losses), net | $ | $ (41) | $ (29) | $ (7) | $ (5) |
| Asset management fees and other income | $ | $ 4 | $ | $ | $ (18) |
| Included in other comprehensive income (loss) | $ | $ | $ 31 | $ | $ |

| | Three Months Ended March 31, 2010 | | | | |
|---|---|---|---|---|---|
| | Other Assets | Separate Account Assets(4) | Future Policy Benefits | Long-term Debt | Other Liabilities |
| | | | (in millions) | | |
| Fair Value, beginning of period | $ 27 | $ 12,894 | $ (55) | $ (429) | $ (6) |
| Total gains or (losses) (realized/unrealized): | | | | | |
| Included in earnings: | | | | | |
| Realized investment gains (losses), net | | | 285 | | 4 |
| Asset management fees and other income | (7) | | | | |
| Interest credited to policyholders account balances | | (188) | | | |
| Included in other comprehensive income (loss) | | | | | |
| Net investment income | | | | | |
| Purchases, sales, issuances and settlements | | 19 | (64) | 429 | |
| Transfers into Level 3(2) | | 8 | | | |
| Transfers out of Level 3(2) | | (93) | | | |
| Fair Value, end of period | $ 20 | $ 12,640 | $ 166 | $ | $ (2) |

| | | | | | |
|---|---|---|---|---|---|
| Unrealized gains (losses) for the period relating to those Level 3 assets and liabilities that were still held at the end of the period(3): | | | | | |
| Included in earnings: | | | | | |
| Realized investment gains (losses), net | $ | $ | $ 282 | $ | $ 4 |
| Asset management fees and other income | $ (7) | $ | $ | $ | $ |
| Interest credited to policyholders account balances | $ | $ (378) | $ | $ | $ |
| Included in other comprehensive income (loss) | $ | $ | $ | $ | $ |

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**PRUDENTIAL FINANCIAL, INC.**

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

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

**Transfers** Transfers into Level 3 for Fixed Maturities Available for Sale Corporate Securities and Trading Account Assets Supporting Insurance Liabilities Commercial Mortgage-Backed Securities were primarily the result of unobservable inputs utilized within valuation methodologies and the use of broker quotes (that could not be validated) when previously, information from third party pricing services (that could be validated) was utilized. Transfers out of Level 3 for Fixed Maturities Available for Sale Commercial Mortgage-Backed Securities were 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 was able to validate.

The following tables provide a summary of the changes in fair value of Level 3 assets and liabilities for the three months ended March 31, 2009, as well as the portion of gains or losses included in income for the three months ended March 31, 2009 attributable to unrealized gains or losses related to those assets and liabilities still held at March 31, 2009.

| | Three Months Ended March 31, 2009 | | | | |
|---|---|---|---|---|---|
| | Fixed Maturities Available For Sale Foreign Government Bonds | Fixed Maturities Available For Sale Corporate Securities | Fixed Maturities Available For Sale Asset-Backed Securities | Fixed Maturities Available For Sale Commercial Mortgage-Backed Securities | Fixed Maturities Available For Sale Residential Mortgage-Backed Securities |
| | | | (in millions) | | |
| Fair Value, beginning of period | $ 30 | $ 932 | $ 1,013 | $ 66 | $ 228 |
| Total gains or (losses) (realized/unrealized): | | | | | |
| Included in earnings: | | | | | |
| Realized investment gains (losses), net | | (45) | (36) | | |
| Asset management fees and other income | | | | | |
| Included in other comprehensive income (loss) | (1) | (70) | (189) | (3) | |
| Net investment income | | 5 | 2 | | |
| Purchases, sales, issuances and settlements | | (4) | (53) | | (17) |
| Foreign currency translation | | | (4) | (1) | |
| Transfers into Level 3(2) | | 263 | 529 | | |
| Transfers out of Level 3(2) | | (40) | (1) | | |
| Fair Value, end of period | $ 29 | $ 1,041 | $ 1,261 | $ 62 | $ 211 |

| | | | | | |
|---|---|---|---|---|---|
| Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(3): | | | | | |
| Included in earnings: | | | | | |
| Realized investment gains (losses), net | $ | $ (43) | $ (36) | $ | $ |
| Asset management fees and other income | $ | $ | $ | $ | $ |
| Included in other comprehensive income (loss) | $ (1) | $ (72) | $ (190) | $ (3) | $ |

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**PRUDENTIAL FINANCIAL, INC.**

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

| | Three Months Ended March 31, 2009 | | | | |
|---|---|---|---|---|---|
| | Trading Account Assets Supporting Insurance Liabilities- Foreign Government Bonds | Trading Account Assets Supporting Insurance Liabilities- Corporate Securities | Trading Account Assets Supporting Insurance Liabilities- Asset Backed Securities | Trading Account Assets Supporting Insurance Liabilities- Commercial Mortgage- Backed Securities | Trading Account Assets Supporting Insurance Liabilities- Residential Mortgage- Backed Securities |
| | | | (in millions) | | |
| Fair Value, beginning of period | $ | $ 75 | $ 35 | $ 6 | $ 28 |
| Total gains or (losses) (realized/unrealized): | | | | | |
| Included in earnings: | | | | | |
| Realized investment gains (losses), net | | | | | |
| Asset management fees and other income | | (8) | (15) | (1) | |
| Included in other comprehensive income (loss) | | | | | |
| Net investment income | | 1 | | | |
| Purchases, sales, issuances and settlements | | (4) | (5) | | |
| Transfers into Level 3(2) | | 74 | 65 | | |
| Transfers out of Level 3(2) | | (2) | | | |
| Fair Value, end of period | $ | $ 136 | $ 80 | $ 5 | $ 28 |
| Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(3): | | | | | |
| Included in earnings: | | | | | |
| Realized investment gains (losses), net | $ | $ | $ | $ | $ |
| Asset management fees and other income | $ | $ (8) | $ (15) | $ (1) | $ |
| Included in other comprehensive income (loss) | $ | $ | $ | $ | $ |

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**PRUDENTIAL FINANCIAL, INC.**

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

| | Three Months Ended March 31, 2009 | | | | |
|---|---|---|---|---|---|
| | Trading Account Assets Supporting Insurance Liabilities-Equity Securities | Other Trading Account Assets-Corporate Securities | Other Trading Account Assets-Asset-Backed Securities | Other Trading Account Assets-Commercial Mortgage-Backed Securities | Other Trading Account Assets-Residential Mortgage-Backed Securities |
| | (in millions) | | | | |
| Fair Value, beginning of period | $ 1 | $ 38 | $ 30 | $ 2 | $ 3 |
| Total gains or (losses) (realized/unrealized): | | | | | |
| Included in earnings: | | | | | |
| Realized investment gains (losses), net | | | | | |
| Asset management fees and other income | | 1 | (38) | | (1) |
| Included in other comprehensive income (loss) | | | | | |
| Net investment income | | | | | |
| Purchases, sales, issuances and settlements | 1 | | 821 | | 1 |
| Transfers into Level 3(2) | | | 2 | | |
| Transfers out of Level 3(2) | | | (4) | | |
| Fair Value, end of period | $ 2 | $ 39 | $ 811 | $ 2 | $ 3 |
| Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(3): | | | | | |
| Included in earnings: | | | | | |
| Realized investment gains (losses), net | $ | $ | $ | $ | $ |
| Asset management fees and other income | $ | $ 1 | $ (38) | $ | $ (1) |
| Included in other comprehensive income (loss) | $ | $ | $ | $ | $ |

| | Three Months Ended March 31, 2009 | | | | |
|---|---|---|---|---|---|
| | Other Trading Account Assets-Equity Securities | Other Trading Account Assets-All Other Activity | Equity Securities Available for Sale | Commercial Mortgage and Other Loans | Other Long-term Investments |
| | (in millions) | | | | |
| Fair Value, beginning of period | $ 19 | $ 1,304 | $ 325 | $ 56 | $ 1,015 |
| Total gains or (losses) (realized/unrealized): | | | | | |
| Included in earnings: | | | | | |
| Realized investment gains (losses), net | | 94 | (4) | (3) | |
| Asset management fees and other income | (2) | 15 | | | (29) |
| Included in other comprehensive income (loss) | | | (3) | | |
| Net investment income | | | | | |
| Purchases, sales, issuances and settlements | | (304) | 17 | (37) | 55 |
| Foreign currency translation | (1) | | (7) | | |
| Other(1) | | | | | (652) |
| Transfers into Level 3(2) | | | | | |
| Transfers out of Level 3(2) | | | (1) | | |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Fair Value, end of period | $ | 16 | $ | 1,109 | $ | 327 | $ | 16 | $ | 389 |
| | | | | | | | | | | |
| Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(3): | | | | | | | | | | |
| Included in earnings: | | | | | | | | | | |
| Realized investment gains (losses), net | $ | | $ | 94 | $ | (4) | $ | (2) | $ | |
| Asset management fees and other income | $ | (2) | $ | | $ | | $ | | $ | (7) |
| Included in other comprehensive income (loss) | $ | | $ | | $ | (3) | $ | | $ | |

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**PRUDENTIAL FINANCIAL, INC.**

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

| | Three Months Ended March 31, 2009 | | | | |
|---|---|---|---|---|---|
| | Other Assets | Separate Account Assets(4) | Future Policy Benefits | Long-term Debt | Other Liabilities |
| | | | (in millions) | | |
| Fair Value, beginning of period | $ 26 | $ 19,780 | $ (3,229) | $ (324) | $ (139) |
| Total gains or (losses) (realized/unrealized): | | | | | |
| Included in earnings: | | | | | |
| Realized investment gains (losses), net | | | 1,435 | | (55) |
| Asset management fees and other income | | | | 40 | |
| Interest credited to policyholders account balances | | (3,518) | | | |
| Included in other comprehensive income (loss) | | | | | |
| Net investment income | | | | | |
| Purchases, sales, issuances and settlements | | 42 | (22) | (776) | |
| Other(1) | | | | 324 | |
| Transfers into Level 3(2) | | 8 | | | |
| Transfers out of Level 3(2) | | (167) | | | |
| Fair Value, end of period | $ 26 | $ 16,145 | $ (1,816) | $ (736) | $ (194) |
| Unrealized gains (losses) for the period relating to those Level 3 assets and liabilities that were still held at the end of the period(3): | | | | | |
| Included in earnings: | | | | | |
| Realized investment gains (losses), net | $ | $ | $ 1,398 | $ | $ (54) |
| Asset management fees and other income | $ | $ | $ | $ 40 | $ |
| Interest credited to policyholders account balances | $ | $ (3,679) | $ | $ | $ |
| Included in other comprehensive income (loss) | $ | $ | $ | $ | $ |

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

**Transfers** Transfers into Level 3 for Fixed Maturities Available for Sale Corporate Securities and Asset-Backed Securities were primarily the result of unobservable inputs utilized within valuation methodologies and the use of broker quotes (that could not be validated) when previously, information from third party pricing services (that could be validated) was utilized. Partially offsetting these transfers into Level 3 were transfers out of Level 3 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 was able to validate. Transfers into Level 3 for Trading Account Assets Supporting Insurance Liabilities-Corporate Securities and Asset-Backed Securities are due to the use of unobservable inputs within the valuation methodologies and broker quotes (that could not be validated), when previously information from third party pricing services (that could be validated) was utilized.

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**PRUDENTIAL FINANCIAL, INC.**

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

**Nonrecurring Fair Value Measurements** Certain assets and liabilities are measured at fair value on a nonrecurring basis. Nonrecurring fair value reserve adjustments resulted in $18 million of net losses being recorded for the three months ended March 31, 2010 on certain commercial mortgage loans. The carrying value of these loans as of March 31, 2010 was $238 million. Similar commercial mortgage loan reserve adjustments of $52 million in net losses were recorded for the three months ended March 31, 2009. The reserve adjustments were based on discounted cash flows utilizing market rates and were classified as Level 3 in the hierarchy. In addition, losses of $4 million were recorded for the three months ended March 31, 2009 related to commercial loans that were carried at the lower of cost or market. The fair value measurements were classified as Level 3 in the valuation hierarchy. The inputs utilized for these valuations are pricing indicators from the whole loan market, which the Company considers its principal market for these loans.

Impairments of $4 million and $23 million were recorded for the three months ended March 31, 2010 and 2009, respectively, on certain cost method investments. The carrying values as of March 31, 2010 and 2009 of these impaired investments are $141 million and $58 million, respectively. These fair value adjustments were based on inputs classified as Level 3 in the valuation hierarchy. The inputs utilized were primarily discounted estimated future cash flows and, where appropriate, valuations provided by the general partners taken into consideration with deal and management fee expenses.

**Fair Value Option** The following table presents information regarding changes in fair values recorded in earnings for commercial mortgage loans and long-term debt, still held as of the reporting dates indicated, where the fair value option has been elected.

| | Three Months Ended March 31, | |
|---|---|---|
| | 2010 | 2009 |
| | (in millions) | |
| Assets: | | |
| Commercial mortgage loans: | | |
| Changes in instrument-specific credit risk | $ (5) | $ (19) |
| Other changes in fair value | $ (2) | $ (2) |
| Liabilities: | | |
| Long-term debt: | | |
| Changes in fair value | $ | $ 40 |

Changes in fair value are reflected in Realized investment gains (losses), net for commercial mortgage loans and Asset management fees and other income for long-term debt. 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. For the three months ended March 31, 2010 and 2009, the Company recorded $6 million and $9 million of interest income, respectively, 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 $359 million and $443 million, respectively, as of March 31, 2010, and $479 million and $556 million, respectively as December 31, 2009. As of March 31, 2010, loans that were in nonaccrual status had fair values of $118 million and aggregate contractual principal amounts of $157 million, respectively.

As of March 31, 2010 the Company no longer has any outstanding debt that is carried at fair value under the fair value option.

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**PRUDENTIAL FINANCIAL, INC.**

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

**Fair Value of Financial Instruments**

The Company is required by U.S. GAAP to disclose the fair value of certain financial instruments including those that are not carried at fair value. For the following financial instruments the carrying amount equals or approximates fair value: fixed maturities classified as available for sale, trading account assets supporting insurance liabilities, other trading account assets, equity securities, securities purchased under agreements to resell, short-term investments, cash and cash equivalents, accrued investment income, separate account assets, investment contracts included in separate account liabilities, securities sold under agreements to repurchase, and cash collateral for loaned securities, as well as certain items recorded within other assets and other liabilities such as broker-dealer related receivables and payables. See Note 14 for a discussion of derivative instruments.

The following table discloses the Company s financial instruments where the carrying amounts and fair values may differ:

| | March 31, 2010 | | December 31, 2009 | |
|---|---|---|---|---|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| | (in millions) | | | |
| **Assets:** | | | | |
| Fixed maturities, held to maturity | $ 5,016 | $ 5,081 | $ 5,120 | $ 5,197 |
| Commercial mortgage and other loans(1) | 30,760 | 30,890 | 31,384 | 30,693 |
| Policy loans | 10,223 | 11,836 | 10,146 | 11,837 |
| **Liabilities:** | | | | |
| Policyholders account balances investment contracts | $ 73,861 | $ 74,616 | $ 73,674 | $ 74,353 |
| Short-term and long-term debt(1) | 24,707 | 25,252 | 24,159 | 24,054 |
| Debt of consolidated VIEs | 413 | 256 | 413 | 239 |
| Bank customer liabilities | 1,579 | 1,594 | 1,523 | 1,538 |

(1) Includes items carried at fair value under the fair value option.

The fair values presented above for those financial instruments where the carrying amounts and fair values may differ have been determined by using available market information and by applying market valuation methodologies, as described in more detail below.

***Fixed Maturities, held to maturity***

The fair values of public fixed maturity securities are generally based on prices from third party pricing services, which are reviewed to validate reasonability. 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 non-binding 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, which utilizes a discount rate based upon the average of spread surveys collected from private market intermediaries who are active in both primary and secondary transactions and takes into account, among other factors, the credit quality and industry sector of the issuer and the reduced liquidity associated with private placements. 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.

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**PRUDENTIAL FINANCIAL, INC.**

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

***Commercial Mortgage and Other Loans***

The fair value of commercial mortgage and other loans, other than those held by the Company s commercial mortgage operations, is primarily based upon the present value of the expected future cash flows discounted at the appropriate U.S. Treasury rate or Japanese Government Bond rate for yen based loans, adjusted for the current market spread for similar quality loans.

The fair value of commercial mortgage and other loans held by the Company s commercial mortgage operations is based upon various factors, including the terms of the loans, the principal exit markets for the loans, prevailing interest rates, and credit risk.

***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- and trust-owned life insurance contracts and group universal life contracts, the fair value of the policy loans is the amount due as of the reporting date.

***Investment Contracts Policyholders Account Balances***

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

***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 VIE s, 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.

**PRUDENTIAL FINANCIAL, INC.**

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

***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.

**14. DERIVATIVE INSTRUMENTS**

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

Interest rate swaps are used by the Company to 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 anticipates acquiring and other anticipated transactions and commitments. 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.

Exchange-traded futures and options are used by the Company to reduce risks from changes in interest rates, to alter mismatches between the duration of assets in a portfolio and the duration of liabilities supported by those assets, and to hedge against changes in the value of securities it owns or anticipates acquiring or selling. 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.

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. The Company also uses currency forwards to hedge the currency risk associated with net investments in foreign operations and anticipated earnings of its foreign operations.

Under currency forwards, the Company agrees with other parties to deliver a specified amount of an identified currency at a specified future date. Typically, the price is agreed upon at the time of the contract and payment for such a contract is made at the specified future date. As noted

above, the Company uses currency forwards to mitigate the risk that unfavorable changes in currency exchange rates will reduce 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. 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.

**PRUDENTIAL FINANCIAL, INC.**

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

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 Note 15 for a discussion of guarantees related to these credit derivatives. In addition to selling credit protection, in limited instances the Company has purchased credit protection using credit derivatives in order to hedge specific credit exposures in the Company s investment portfolio.

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 to achieve better diversification and to enhance the return on its investment portfolio. TBAs 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.

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

The Company sells variable annuity products, which contain 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 to minimize risks inherent in the Company s guarantees which reduces the need for hedges.

The Company sells synthetic guaranteed investment contracts which are investment-only, fee-based stable value products, 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 and recorded at fair value.

**PRUDENTIAL FINANCIAL, INC.**

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

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

The table below provides a summary of the gross notional amount and fair value of derivatives contracts, excluding embedded derivatives which are recorded with the associated host, by the primary underlying. Many derivative instruments contain multiple underlyings.

| | March 31, 2010 | | | December 31, 2009 | | |
|---|---|---|---|---|---|---|
| | Notional | Fair Value | | Notional | Fair Value | |
| | Amount | Assets | Liabilities | Amount | Assets | Liabilities |
| | (in millions) | | | | | |
| **Qualifying Hedge Relationships** | | | | | | |
| Interest Rate | $ 7,333 | $ 107 | $ (459) | $ 7,793 | $ 101 | $ (414) |
| Currency | 1,816 | 22 | (8) | 1,392 | 3 | (17) |
| Currency/Interest Rate | 2,627 | 64 | (246) | 2,452 | 47 | (326) |
| **Total Qualifying Hedge Relationships** | $ 11,776 | $ 193 | $ (713) | $ 11,637 | $ 151 | $ (757) |
| **Non-Qualifying Hedge Relationships** | | | | | | |
| Interest Rate | $ 103,209 | $ 2,761 | $ (1,956) | $ 97,265 | $ 2,545 | $ (2,129) |
| Currency | 11,334 | 174 | (182) | 11,692 | 223 | (220) |
| Credit | 3,537 | 85 | (103) | 3,788 | 259 | (110) |
| Currency/Interest Rate | 5,198 | 156 | (197) | 5,396 | 122 | (268) |
| Equity | 8,369 | 442 | (105) | 7,126 | 618 | (86) |
| **Total Non-Qualifying Hedge Relationships** | $ 131,647 | $ 3,618 | $ (2,543) | $ 125,267 | $ 3,767 | $ (2,813) |
| **Total Derivatives(1)** | $ 143,423 | $ 3,811 | $ (3,256) | $ 136,904 | $ 3,918 | $ (3,570) |

(1) Excludes embedded derivatives which contain multiple underlyings. The fair value of these embedded derivatives was a liability of $142 million as of March 31, 2010 and a liability of $391 million as of December 31, 2009, included in Future policy benefits and Fixed maturities, available for sale.

***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.

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**PRUDENTIAL FINANCIAL, INC.**

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

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 March 31, 2010 | Three Months Ended March 31, 2009 |
|---|---|---|
| | (in millions) | |
| **Qualifying Hedges** | | |
| **Fair value hedges** | | |
| *Interest Rate* | | |
| Realized investment gains (losses), net | $ (13) | $ 96 |
| Net investment income | (43) | (40) |
| Interest expense-(increase)/decrease | 3 | 1 |
| Interest credited to policyholder account balances-(increase)/decrease | 18 | 12 |
| *Currency* | | |
| Realized investment gains (losses), net | 33 | |
| Net investment income | (1) | |
| Other income | | 2 |
| Total fair value hedges | $ (3) | $ 71 |
| **Cash flow hedges** | | |
| *Interest Rate* | | |
| Interest expense-(increase)/decrease | (5) | (4) |
| Interest credited to policyholder account balances-(increase)/decrease | (1) | (1) |
| Accumulated other comprehensive income (loss)(1) | (7) | 22 |
| *Currency/Interest Rate* | | |
| Net investment income | (3) | (2) |
| Other income | (4) | (4) |
| Accumulated other comprehensive income (loss)(1) | 68 | 19 |
| Total cash flow hedges | $ 48 | $ 30 |
| **Net investment hedges** | | |
| *Currency* | | |
| Realized investment gains (losses), net(2) | | 9 |
| Accumulated other comprehensive income (loss)(1) | 6 | 110 |
| *Currency/Interest Rate* | | |
| Accumulated other comprehensive income (loss)(1) | 38 | 61 |
| Total net investment hedges | $ 44 | $ 180 |
| **Non-qualifying Hedges** | | |
| *Realized investment gains (losses), net* | | |
| Interest Rate | 409 | (540) |
| Currency | 78 | 194 |

| | | |
|---|---|---|
| Currency/Interest Rate | 86 | 31 |
| Credit | (46) | (18) |
| Equity | (290) | 202 |
| Embedded Derivatives (Interest/Equity/Credit) | 327 | 1,279 |
| Total non-qualifying hedges | $ 564 | $ 1,148 |
| **Total Derivative Impact** | $ 653 | $ 1,429 |

(1) Amounts deferred in Equity.
(2) Relates to the sale of equity method investments.

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**PRUDENTIAL FINANCIAL, INC.**

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

For the period ending March 31, 2010 the ineffective portion of derivatives accounted for using hedge accounting was not material to the Company s results of operations and there were no material amounts reclassified into earnings relating to instances in which the Company discontinued cash flow hedge accounting because the forecasted transaction did not occur by the anticipated date or within the additional time period permitted by the authoritative guidance for the accounting for derivatives and hedging. In addition, there were no instances in which the Company discontinued fair value hedge accounting due to a hedged firm commitment no longer qualifying as a fair value hedge.

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, 2009 | $ (317) |
| Net deferred gains on cash flow hedges from January 1 to March 31, 2010 | 46 |
| Amount reclassified into current period earnings | 15 |
| Balance, March 31, 2010 | $ (256) |

Using March 31, 2010 values it is anticipated that a pre-tax loss of approximately $25 million will be reclassified from Accumulated other comprehensive income (loss) to earnings during the subsequent twelve months ending March 31, 2011, offset by amounts pertaining to the hedged items. As of March 31, 2010, 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 13 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 Unaudited Interim 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 $171 million and $127 million as of March 31, 2010 and December 31, 2009, respectively.

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**PRUDENTIAL FINANCIAL, INC.**

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

***Credit Derivatives Written***

The following tables set forth the Company s exposure from credit derivatives where the Company has written credit protection, excluding 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, by NAIC rating of the underlying credits as of March 31, 2010 and December 31, 2009.

| | | | March 31, 2010 | | | |
|---|---|---|---|---|---|---|
| | Single Name | | First to Default Basket | | Total | |
| **NAIC Designation(1)** | **Notional** | **Fair Value** | **Notional** | **Fair Value** | **Notional** | **Fair value** |
| | | | (in millions) | | | |
| 1 | $ 320 | $ 2 | $ 140 | $ | $ 460 | $ 2 |
| 2 | 28 | | 303 | (1) | 331 | (1) |
| Subtotal | 348 | 2 | 443 | (1) | 791 | 1 |
| 3 | | | 92 | (1) | 92 | (1) |
| 4 | | | 15 | | 15 | |
| 5 | | | 50 | | 50 | |
| 6 | | | | | | |
| Subtotal | | | 157 | (1) | 157 | (1) |
| Total | $ 348 | $ 2 | $ 600 | $ (2) | $ 948 | $ |

| | | | December 31, 2009 | | | |
|---|---|---|---|---|---|---|
| | Single Name | | First to Default Basket | | Total | |
| **NAIC Designation(1)** | **Notional** | **Fair Value** | **Notional** | **Fair Value** | **Notional** | **Fair value** |
| | | | (in millions) | | | |
| 1 | $ 323 | $ 3 | $ 140 | $ | $ 463 | $ 3 |
| 2 | 28 | | 303 | (3) | 331 | (3) |
| Subtotal | 351 | 3 | 443 | (3) | 794 | |
| 3 | | | 132 | (2) | 132 | (2) |
| 4 | | | | | | |
| 5 | | | 50 | (1) | 50 | (1) |
| 6 | | | | | | |
| Subtotal | | | 182 | (3) | 182 | (3) |
| Total | $ 351 | $ 3 | $ 625 | $ (6) | $ 976 | $ (3) |

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

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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 excluding the 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, by industry category as of the dates indicated.

| | March 31, 2010 | | December 31, 2009 | |
|---|---|---|---|---|
| **Industry** | **Notional** | **Fair Value** | **Notional** | **Fair Value** |
| | | (in millions) | | |
| Corporate Securities: | | | | |
| Manufacturing | $ 45 | $ | $ 45 | $ |
| Utilities | 5 | | 5 | |
| Finance | | | | |
| Services | 28 | | 31 | |
| Energy | 20 | | 20 | |
| Transportation | 30 | | 30 | |
| Retail and Wholesale | 30 | | 30 | |
| Other | 190 | 2 | 190 | 3 |
| First to Default Baskets(1) | 600 | (2) | 625 | (6) |
| Total Credit Derivatives | $ 948 | $ | $ 976 | $ (3) |

(1) Credit default baskets may include various industry categories.

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 March 31, 2010 and December 31, 2009 was a liability of $25 million and $22 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 value 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 $747 million and $723 million at March 31, 2010 and December 31, 2009, 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 March 31, 2010 and December 31, 2009, the Company had $2.090 billion and $2.313

billion of outstanding notional amounts, respectively, reported at fair value as an asset of $7 million and an asset of $174 million, respectively.

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

Futures, forwards and options contracts, and swap agreements, are also used in a derivative dealer or broker capacity in the Company s commodities operations to facilitate transactions of the Company s clients, hedge proprietary trading activities and as a means of risk management. These derivatives allow the Company to

**PRUDENTIAL FINANCIAL, INC.**

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

structure transactions to manage its exposure to commodities and securities prices, foreign exchange rates and interest rates. Risk exposures are managed through diversification, by controlling position sizes and by entering into offsetting positions. For example, the Company may manage the risk related to its precious metals inventory by entering into an offsetting position in exchange traded futures contracts.

The fair value of the Company s derivative contracts used in a derivative dealer or broker capacity is 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 are recognized on a trade date basis and reported in Asset management fees and other income.

The following table sets forth the income statement impact of derivatives used in a dealer or broker capacity.

| | Three Months Ended March 31, | |
|---|---|---|
| | **2010** | **2009** |
| | **(in millions)** | |
| **Asset management fees and other income** | | |
| Interest Rate | $ (2) | $ 2 |
| Credit | | |
| Commodity | 12 | 15 |
| Currency | 7 | 9 |
| Equity | 3 | 2 |
| Total asset management fees and other income | $ 20 | $ 28 |

***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.

**PRUDENTIAL FINANCIAL, INC.**

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

Certain of the Company s derivative agreements with some of its counterparties contain credit-risk related triggers. If the Company s credit rating were to fall below a certain level, the counterparties to the derivative instruments could request termination at the then fair value of the derivative or demand immediate full collateralization on derivative instruments in net liability positions. If a downgrade occurred and the derivative positions were terminated, the Company anticipates it would be able to replace the derivative positions with other counterparties in the normal course of business. The aggregate fair value of all derivative instruments with credit-risk-related contingent features that are in a net liability position were $454 million as of March 31, 2010. In the normal course of business the Company has posted collateral related to these instruments of $376 million as of March 31, 2010. If the credit-risk-related contingent features underlying these agreements had been triggered on March 31, 2010, the Company estimates that it would be required to post a maximum of $78 million of additional collateral to its counterparties.

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

***Commitments and Guarantees Off-Balance Sheet Arrangements***

The following information presents the Company s off-balance sheet commitments and guarantees:

***Commercial Mortgage Loan Commitments***

| | As of March 31, 2010 (in millions) |
|---|---|
| Total outstanding mortgage loan commitments | $ 2,055 |
| Portion of commitment where prearrangement to sell to investor exists | $ 1,104 |

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 prearranges 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 March 31, 2010 (in millions) |
|---|---|
| Expected to be funded from the general account and other operations outside the separate accounts | $ 3,316 |

| | | |
|---|---|---|
| Expected to be funded from separate accounts | $ | 3,891 |
| Portion of separate account commitments with recourse to Prudential Insurance | $ | 1,628 |

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.

**PRUDENTIAL FINANCIAL, INC.**

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

***Guarantees of Investee Debt***

| | As of March 31, 2010 (in millions) | |
|---|---|---|
| Total guarantees of debt issued by entities in which the separate accounts have invested | $ | 1,888 |
| Amount of above guarantee that is limited to separate account assets | $ | 1,775 |
| 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 to guarantees limited to fraud, criminal activity or other bad acts. These guarantees generally expire at various times over the next fifteen years. At March 31, 2010, 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.

***Guarantee of Retail Development Project Costs***

| | As of March 31, 2010 (in millions) | |
|---|---|---|
| Guarantee of development costs and interest servicing on retail development project | $ | 201 |
| Accrued liability associated with guarantee | $ | |

The Company has provided a guarantee to a syndication of lenders in connection with a retail development project in Singapore that is 50% co-owned by the Company and an unconsolidated real estate fund managed by the Company. The principal provisions in the guarantee require that the loan-to-value ratio of the retail development project be maintained at 60% or lower, based on an external appraisal. A loan-to-value ratio in excess of 60% would require the Company and its co-owner to jointly and severally paydown the loan balance to the 60% level. The loan-to-value ratio, based on a December 2009 appraisal plus additional costs to the development in 2010, is 53.5%. Other obligations under the guarantee include guaranteeing the interest-servicing on the loan on a proportionate basis and undertaking to complete the project and fund all development costs, including cost overruns. The Company s exposure under the guarantee assumes the co-owner honors its joint guarantee.

***Indemnification of Securities Lending Transactions***

| | As of March 31, 2010 (in millions) | |
|---|---|---|
| Indemnification provided to mutual fund and separate account clients for securities lending | $ | 10,742 |

| | | |
|---|---|---|
| Fair value of related collateral associated with above indemnifications | $ | 11,039 |
| 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.

**PRUDENTIAL FINANCIAL, INC.**

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

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

***Credit Derivatives Written***

| | As of March 31, 2010 (in millions) | |
|---|---|---|
| Credit derivatives written maximum amount at risk | $ | 948 |
| Accrued amount associated with guarantee | $ | |

As discussed 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. The Company s maximum amount at risk under these credit derivatives listed above assumes the value of the underlying referenced securities become worthless. These credit derivatives generally have maturities of five years or less.

***Guarantees of Asset Values***

| | As of March 31, 2010 (in millions) | |
|---|---|---|
| Guaranteed value of third parties assets | $ | 12,087 |
| Fair value of collateral supporting these assets | $ | 12,347 |
| Accrued liability associated with guarantee | $ | 1 |

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 March 31, 2010**

| | | (in millions) |
|---|---|---|
| Guarantees of credit enhancements of debt instruments associated with commercial real estate assets | $ | 219 |
| Fair value of properties and associated tax credits that secure the guarantee | $ | 272 |
| Accrued liability associated with guarantee | $ | |

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

**PRUDENTIAL FINANCIAL, INC.**

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

estate. The Company receives certain ongoing fees for providing these enhancement arrangements and anticipates the extinguishment of its obligation under these enhancements prior to maturity through the aggregation and transfer of its positions to a substitute enhancement provider.

***Indemnification of Serviced Mortgage Loans***

| | As of March 31, 2010 (in millions) | |
|---|---|---|
| Maximum exposure under indemnification agreements for mortgage loans serviced by the Company | $ | 1,072 |
| First-loss exposure portion of above | $ | 344 |
| Accrued liability associated with guarantees | $ | 30 |

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 make 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 $8,274 million of mortgages subject to these loss-sharing arrangements as of March 31, 2010, all of which are collateralized by first priority liens on the underlying multi-family residential properties. As of March 31, 2010, these mortgages had an average debt service coverage ratio of 1.71 times and an average loan-to-value ratio of 72%. The Company had no losses related to the indemnifications that were settled in the first three months of 2010 or 2009.

***Contingent Consideration***

| | As of March 31, 2010 (in millions) | |
|---|---|---|
| Maximum potential contingent consideration associated with acquisitions | $ | 112 |

In connection with certain acquisitions, the Company has agreed to pay additional consideration in future periods, contingent upon the attainment by the acquired entity of defined operating objectives. These arrangements will be resolved over the following four years. Any such payments would result in increases in intangible assets, such as goodwill.

***Other Guarantees***

| | As of March 31, 2010 (in millions) |
|---|---|
| Other guarantees where amount can be determined | $ 255 |
| Accrued liability for other guarantees and indemnifications | $ 8 |

The Company is also subject to other financial guarantees and indemnity arrangements. The Company has provided indemnities and guarantees related to acquisitions, dispositions, investments and other transactions that

**PRUDENTIAL FINANCIAL, INC.**

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

are triggered by, among other things, breaches of representations, warranties or covenants provided by the Company. These obligations are typically subject to various time limitations, defined by the contract or by operation of law, such as statutes of limitation. In some cases, the maximum potential obligation is subject to contractual limitations, while in other cases such limitations are not specified or applicable. 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.

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 a litigation or regulatory matter, and the amount or range of potential loss at any particular time, is often inherently uncertain.

**Individual Life and Group Insurance**

In April 2009, a purported nationwide class action, *Schultz v. The Prudential Insurance Company of America,* was filed in the United States District Court for the Northern District of Illinois. In January 2010, the court dismissed the complaint without prejudice. In February 2010, plaintiff sought leave to amend the complaint to add another plaintiff and to name the ERISA welfare plans in which they were participants

individually and as representatives of a purported defendant class of ERISA welfare plans for which Prudential offset benefits. The proposed amended complaint alleges that Prudential Insurance and the welfare plans violated ERISA by offsetting family Social Security benefits against Prudential contract benefits and seeks a declaratory judgment that the offsets are unlawful as they are not loss of time benefits and recovery of the amounts by which the challenged offsets reduced the disability payments.

**PRUDENTIAL FINANCIAL, INC.**

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

From November 2002 to March 2005, eleven separate complaints were filed against the Company and the law firm of Leeds Morelli & Brown in New Jersey state court. The cases were consolidated for pre-trial proceedings in New Jersey Superior Court, Essex County and captioned *Lederman v. Prudential Financial, Inc., et al.* The complaints allege that an alternative dispute resolution agreement entered into among Prudential Insurance, over 350 claimants who are current and former Prudential Insurance employees, and Leeds Morelli & Brown (the law firm representing the claimants) was illegal and that Prudential Insurance conspired with Leeds Morelli & Brown to commit fraud, malpractice, breach of contract, and violate racketeering laws by advancing legal fees to the law firm with the purpose of limiting Prudential s liability to the claimants. In 2004, the Superior Court sealed these lawsuits and compelled them to arbitration. In May 2006, the Appellate Division reversed the trial court s decisions, held that the cases were improperly sealed, and should be heard in court rather than arbitrated. In March 2007, the court granted plaintiffs motion to amend the complaint to add over 200 additional plaintiffs and a claim under the New Jersey discrimination law but denied without prejudice plaintiffs motion for a joint trial on liability issues. In June 2007, Prudential Financial and Prudential Insurance moved to dismiss the complaint. In November 2007, the court granted the motion, in part, and dismissed the commercial bribery and conspiracy to commit malpractice claims, and denied the motion with respect to other claims. In January 2008, plaintiffs filed a demand pursuant to New Jersey law stating that they were seeking damages in the amount of $6.5 billion. In February 2010, the New Jersey Supreme Court assigned the cases for centralized case management to the Superior Court, Bergen County.

The Company, along with a number of other insurance companies, received formal requests for information from the State of New York Attorney General s Office ( NYAG ), the Securities and Exchange Commission ( SEC ), the Connecticut Attorney General s Office, the Massachusetts Office of the Attorney General, the Department of Labor, the United States Attorney for the Southern District of California, the District Attorney of the County of San Diego, and various state insurance departments relating to payments to insurance intermediaries and certain other practices that may be viewed as anti-competitive. In December 2006, Prudential Insurance reached a resolution of the NYAG investigation. Under the terms of the settlement, Prudential Insurance paid a $2.5 million penalty and established a $16.5 million fund for policyholders, adopted business reforms and agreed, among other things, to continue to cooperate with the NYAG in any litigation, ongoing investigations or other proceedings. Prudential Insurance also settled the litigation brought by the California Department of Insurance and agreed to business reforms and disclosures as to group insurance contracts insuring customers or residents in California and to pay certain costs of investigation. In April 2008, Prudential Insurance reached a settlement of proceedings relating to payments to insurance intermediaries and certain other practices with the District Attorneys of San Diego, Los Angeles and Alameda counties. Pursuant to this settlement, Prudential Insurance paid $350,000 in penalties and costs. These matters are also the subject of litigation brought by private plaintiffs, including purported class actions that have been consolidated in the multidistrict litigation in the United States District Court for the District of New Jersey, *In re Employee Benefit Insurance Brokerage Antitrust Litigation.* In August and September 2007, the court dismissed the antitrust and RICO claims. In January and February 2008, the court dismissed the ERISA claims with prejudice and the state law claims without prejudice. Plaintiffs have appealed the dismissal of the antitrust and RICO claims to the United States Court of Appeals for the Third Circuit.

**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 s fiduciary capacity and on behalf of certain defined benefit and defined contribution plan clients of PRIAC, against an unaffiliated asset manager, State Street Global Advisors ( SSgA ) and SSgA s affiliate, State Street Bank and Trust Company ( State Street ). This action seeks, among other

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**PRUDENTIAL FINANCIAL, INC.**

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

relief, restitution of certain losses attributable to certain investment funds sold by SSgA as to which PRIAC believes SSgA employed investment strategies and practices that were misrepresented by SSgA and failed to exercise the standard of care of a prudent investment manager. PRIAC also intends to vigorously pursue any other available remedies against SSgA and State Street in respect of this matter. Given the unusual circumstances surrounding the management of these SSgA funds and in order to protect the interests of the affected plans and their participants while PRIAC pursues these remedies, PRIAC implemented a process under which affected plan clients that authorized PRIAC to proceed on their behalf have received payments from funds provided by PRIAC for the losses referred to above. The Company s consolidated financial statements, and the results of the Retirement segment included in the Company s 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 subprime investments, resulting in significant investor losses in mid-2007. Under the settlement, State Street agreed to pay approximately $313 million in disgorgement, pre-judgment interest, penalty and compensation into a Fair Fund that will be distributed to injured investors. Consequently, State Street agreed to pay PRIAC, for deposit into its separate accounts, approximately $52.5 million within 14 days of the entry of a final judgment by the United States District Court for the District of Massachusetts. 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 February 2010, the United States District Court for the District of Massachusetts entered final judgment and, in March 2010, in compliance with the court order, State Street paid PRIAC approximately $52.5 million, the penalty portion of which (approximately $8.4 million) will be distributed to affected PRIAC clients.

In June 2009, special bankruptcy counsel for Lehman Brothers Holdings Inc. ( LBHI ), Lehman Brothers Special Financing ( LBSF ) and certain of their affiliates made a demand of Prudential Global Funding LLC ( PGF ), a subsidiary of the Company, for the return of a portion of the $550 million in collateral delivered by LBSF to PGF pursuant to swap agreements and a cross margining and netting agreement between PGF, LBSF and Lehman Brothers Finance S.A. a/k/a Lehman Brothers Finance AG ( Lehman Switzerland ), a Swiss affiliate that is subject to insolvency proceedings in the United States and Switzerland. LBSF claims that PGF wrongfully applied the collateral to Lehman Switzerland s obligations in violation of the automatic stay in LBSF s bankruptcy case, which is jointly administered under *In re Lehman Brothers Holdings Inc.* in the United States Bankruptcy Court in the Southern District of New York (the Lehman Chapter 11 Cases ). In August 2009, PGF filed a declaratory judgment action in the same court against LBSF, Lehman Switzerland and LBHI (as guarantor of LBSF and Lehman Switzerland under the swap agreements) seeking an order that (a) PGF had an effective lien on the collateral that secured the obligations of both LBSF ($197 million) and Lehman Switzerland ($488 million) and properly foreclosed on the collateral leaving PGF with an unsecured $135 million claim against LBSF (and LBHI as guarantor) or, in the alternative, (b) PGF was entitled, under the Bankruptcy Code, to set off amounts owed by Lehman Switzerland against the collateral and the automatic stay was inapplicable. The declaratory judgment action is captioned *Prudential Global Funding LLC v. Lehman Brothers Holdings Inc., et al.* In addition, PGF filed timely claims against LBSF and LBHI in the Lehman Chapter 11 Cases for any amounts due under the swap agreements, depending on the results of the declaratory judgment action. In October 2009, LBSF and LBHI answered in the declaratory judgment action and asserted

**PRUDENTIAL FINANCIAL, INC.**

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

counterclaims that PGF breached the swap agreement, seeking a declaratory judgment that PGF had a perfected lien on only $178 million of the collateral that could be applied only to amounts owed by LBSF and no right of set off against Lehman Switzerland s obligations, as well as the return of collateral in the amount of $372 million plus interest and the disallowance of PGF s claims against LBSF and LBHI. LBSF and LBHI also asserted cross-claims against Lehman Switzerland seeking return of the collateral. In December 2009, PGF filed a motion for judgment on the pleadings to resolve the matter in its favor. In February 2010, LBSF and LBHI cross-moved for judgment on the pleadings.

**Securities**

Prudential Securities was a defendant in a number of industry-wide purported class actions in the United States District Court for the Southern District of New York relating to its former securities underwriting business, captioned *In re: Initial Public Offering Securities Litigation,* alleging, among other things, that the underwriters engaged in a scheme involving tying agreements, undisclosed compensation arrangements and research analyst conflicts to manipulate and inflate the prices of shares sold in initial public offerings in violation of the federal securities laws. In September 2009, the court entered a final order approving settlement of *In re: Initial Public Offering Securities Litigation.* In October 2009, an objector filed a notice of appeal challenging the certification of the settlement class. The appeal is pending before the United States Court of Appeals for the Second Circuit.

**Other Matters**

*Mutual Fund Market Timing Practices*

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

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**PRUDENTIAL FINANCIAL, INC.**

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

litigation, ongoing investigations or other proceedings relating to or arising from their investigations into these matters. In connection with the settlements, the Company agreed with the USAO, among other things, to cooperate with the USAO and to maintain and periodically report on the effectiveness of its compliance procedures. The settlement documents include findings and admissions that may adversely affect existing litigation or cause additional litigation and result in adverse publicity and other potentially adverse impacts to the Company s businesses.

In addition to the regulatory proceedings described above that were settled in 2006, in October 2004, the Company and Prudential Securities were named as defendants in several class actions brought on behalf of purchasers and holders of shares in a number of mutual fund complexes. The actions are consolidated as part of a multi-district proceeding, *In re: Mutual Fund Investment Litigation,* pending in the United States District Court for the District of Maryland. The complaints allege that the purchasers and holders were harmed by dilution of the funds values and excessive fees, caused by market timing and late trading, and seek unspecified damages. In August 2005, the Company was dismissed from several of the actions, without prejudice to repleading the state claims, but remains a defendant in other actions in the consolidated proceeding. In July 2006, in one of the consolidated mutual fund actions, *Saunders v. Putnam American Government Income Fund, et al.,* the United States District Court for the District of Maryland granted plaintiffs leave to refile their federal securities law claims against Prudential Securities. In August 2006, the second amended complaint was filed alleging federal securities law claims on behalf of a purported nationwide class of mutual fund investors seeking compensatory and punitive damages in unspecified amounts. In June 2008, the Company was dismissed with prejudice from the remaining actions consolidated in *In re: Mutual Fund Investment Litigation* other than *Saunders v. Putnam American Government Income Fund, et al.* In July 2008, the Company moved for summary judgment and plaintiffs moved for class certification in *Saunders.* In May 2010, in *Saunders,* plaintiffs moved for preliminary approval of class settlements with all defendants, including Prudential Securities, and for certification of a settlement class.

Commencing in 2003, the Company received formal requests for information from the SEC and NYAG relating to market timing in variable annuities by certain American Skandia entities. In connection with these investigations, with the approval of Skandia, an offer was made by American Skandia to the SEC and NYAG, to settle these matters by paying restitution and a civil penalty. In April 2009, AST Investment Services, Inc., formerly named American Skandia Investment Services, Inc. ( ASISI ), reached a resolution of these investigations by the SEC and NYAG into market timing related misconduct involving certain variable annuities. The settlements relate to conduct that generally occurred between January 1998 and September 2003. The Company acquired ASISI from Skandia in May 2003. Subsequent to the acquisition, the Company implemented controls, procedures and measures designed to protect customers from the types of activities involved in these investigations. These settlements resolve the investigations by the above named authorities into these matters, subject to the settlement terms. Under the terms of the settlements, ASISI paid a total of $34 million in disgorgement and an additional $34 million as a civil money penalty into a Fair Fund administered by the SEC to compensate those harmed by the market timing related activities. Pursuant to the settlements, ASISI has retained, at its ongoing cost and expense, the services of an Independent Distribution Consultant acceptable to the Staff of the SEC to develop a proposed distribution plan for the distribution of Fair Fund amounts according to a methodology developed in consultation with and acceptable to the Staff. As part of these settlements, ASISI hired an independent third party, which has conducted a compliance review and issued a report of its findings and recommendations to ASISI s Board of Directors, the Audit Committee of the Advanced Series Trust Board of Trustees and the Staff of the SEC. In addition, ASISI has agreed, among other things, to continue to cooperate with the SEC and NYAG in any litigation, ongoing investigations or other proceedings relating to or arising from their investigations into these matters. Under the terms of the purchase agreement pursuant to which the Company acquired ASISI from Skandia, the Company was indemnified for the settlements.

**PRUDENTIAL FINANCIAL, INC.**

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

*Corporate*

In April 2009, the Company s Board of Directors (the Board ) received a letter demanding that the Board take action to recover allegedly improperly paid compensation to certain current and former employees and executive officers of the Company since at least 2005. The demand is made by a Prudential Financial stockholder, Service Employees International Union Pension Plans Master Trust ( SEIU ), and is one of many that SEIU has sent to large corporations. SEIU claims that the Company must bring an action, under theories of unjust enrichment and corporate waste, to recoup incentive compensation that was based on allegedly flawed economic metrics. SEIU also seeks rescission of exercised stock options because the options were based on mistaken facts concerning the fair value of the Company s stock. The letter states that between 2005 and 2008 the Company paid cash and equity compensation of approximately $165 million to its senior executives and authorized senior executives to exercise stock options worth approximately $66 million. The letter also demands that the Board enjoin any further approved, but unpaid, compensation payments, overhaul the Company s compensation structure, and allow stockholders an advisory vote on the Compensation Committee s report in the Company s annual proxy statement. SEUI reserves the right to bring a derivative action should the Board decline to act. In May 2009, the Board formed a Special Evaluation Committee, comprised of independent directors, and authorized the Committee to hire outside advisors and experts to assist in its evaluation of the demand letter. The Committee has engaged counsel that is reviewing the matter.

In March 2009, a purported class action, *Bauer v. Prudential Financial, et al.,* was filed in the United States District Court for the District of New Jersey. The case names as defendants, the Company, certain Company Directors, the Chief Financial Officer, Controller and former Chief Executive Officer and former Principal Accounting Officer, underwriters and the Company s independent auditors. The complaint, brought on behalf of purchasers of the Company s 9% Junior Subordinated Notes (retail hybrid subordinated debt), alleges that the Company s March 2006 Form S-3 Registration Statement and Prospectus and the June 2008 Prospectus Supplement, both of which incorporated other public filings, contained material misstatements or omissions. In light of the Company s disclosures in connection with its 2008 financial results, plaintiffs contend that the earlier offering documents failed to disclose impairments in the Company s asset-backed securities collateralized with subprime mortgages and goodwill associated with certain subsidiaries and other assets, and that the Company had inadequate controls relating to such reporting. The complaint asserts violations of the Securities Act of 1933, alleging Section 11 claims against all defendants, Section 12(a)(2) claims against the Company and underwriters and Section 15 claims against the individual defendants, and seeks unspecified compensatory and rescission damages, interest, costs, fees, expenses and such injunctive relief as may be deemed appropriate by the court. In April 2009, two additional purported class action complaints were filed in the same court, *Haddock v. Prudential Financial, Inc. et al. and Pinchuk v. Prudential Financial, Inc. et al.* The complaints essentially allege the same claims and seek the same relief as *Bauer.* In June 2009, *Pinchuk* was voluntarily dismissed and the *Haddock* and *Bauer* matters were consolidated. In July 2009, an amended consolidated complaint was filed that added claims regarding contingent liability relating to the auction rate securities markets and reserves relating to annuity contract holders. The complaint restates the claims regarding impairments related to mortgage backed securities, but does not include prior claims regarding goodwill impairments. The complaint names all of the same defendants as the prior complaints, with the exception of the Company s independent auditors. In September 2009, defendants filed a motion to dismiss the complaint. The motion is pending.

*Other*

In October 2006, a 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 Insurance failed to pay overtime to insurance agents who were registered representatives in violation of federal and Pennsylvania law, and that improper deductions were made from these agents wages in violation

**PRUDENTIAL FINANCIAL, INC.**

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

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. In March 2008, a purported nationwide class action lawsuit was filed in the United States District Court for the Southern District of California, *Wang v. Prudential Financial, Inc. and Prudential Insurance,* on behalf of agents who sold the Company s financial products. The complaint alleges claims that the Company failed to pay overtime and provide other benefits in violation of California and federal law and seeks compensatory and punitive damages in unspecified amounts. In September 2008, *Wang* was transferred to the United States District Court for the District of New Jersey and consolidated with the *Bouder* matter. In January 2009, an amended complaint was filed in the consolidated matter which adds wage claims based on the laws of thirteen additional states. In March 2009, a second amended complaint was filed which dropped the breach of contract claims. The Company moved to dismiss certain of the state claims in the consolidated complaint. In December 2009, certain of the state claims were dismissed. In February 2010, Prudential moved to decertify the federal wage and hour class conditionally certified in March 2008, and moved for summary judgment as to the federal wage and hour claims of the named plaintiffs.

**Summary**

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

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**PRUDENTIAL FINANCIAL, INC.**

**Unaudited Interim Supplemental Combining Statements of Financial Position**

**March 31, 2010 and December 31, 2009 (in millions)**

| | March 31, 2010 | | | December 31, 2009 | | |
|---|---|---|---|---|---|---|
| | Financial Services Business | Closed Block Business | Consolidated | Financial Services Business | Closed Block Business | Consolidated |
| **ASSETS** | | | | | | |
| Fixed maturities, available for sale, at fair value | $ 136,792 | $ 43,658 | $ 180,450 | $ 132,694 | $ 42,531 | $ 175,225 |
| Fixed maturities, held to maturity, at amortized cost | 5,016 | | 5,016 | 5,120 | | 5,120 |
| Trading account assets supporting insurance liabilities, at fair value | 16,683 | | 16,683 | 16,020 | | 16,020 |
| Other trading account assets, at fair value | 3,222 | 149 | 3,371 | 2,866 | 167 | 3,033 |
| Equity securities, available for sale, at fair value | 3,824 | 3,264 | 7,088 | 3,810 | 3,085 | 6,895 |
| Commercial mortgage and other loans | 22,557 | 8,203 | 30,760 | 23,021 | 8,363 | 31,384 |
| Policy loans | 4,825 | 5,398 | 10,223 | 4,728 | 5,418 | 10,146 |
| Other long-term investments | 4,340 | 1,620 | 5,960 | 4,359 | 1,545 | 5,904 |
| Short-term investments | 5,826 | 1,098 | 6,924 | 5,487 | 1,338 | 6,825 |
| Total investments | 203,085 | 63,390 | 266,475 | 198,105 | 62,447 | 260,552 |
| Cash and cash equivalents | 8,996 | 630 | 9,626 | 12,451 | 713 | 13,164 |
| Accrued investment income | 1,657 | 711 | 2,368 | 1,668 | 654 | 2,322 |
| Deferred policy acquisition costs | 13,962 | 756 | 14,718 | 13,751 | 827 | 14,578 |
| Other assets | 15,597 | 456 | 16,053 | 15,222 | 291 | 15,513 |
| Separate account assets | 182,621 | | 182,621 | 174,074 | | 174,074 |
| **TOTAL ASSETS** | $ 425,918 | $ 65,943 | $ 491,861 | $ 415,271 | $ 64,932 | $ 480,203 |
| **LIABILITIES AND EQUITY** | | | | | | |
| **LIABILITIES** | | | | | | |
| Future policy benefits | $ 74,103 | $ 51,640 | $ 125,743 | $ 73,931 | $ 51,776 | $ 125,707 |
| Policyholders account balances | 96,082 | 5,569 | 101,651 | 96,078 | 5,588 | 101,666 |
| Policyholders dividends | 256 | 1,531 | 1,787 | 328 | 926 | 1,254 |
| Securities sold under agreements to repurchase | 2,969 | 3,142 | 6,111 | 2,985 | 3,048 | 6,033 |
| Cash collateral for loaned securities | 2,380 | 800 | 3,180 | 2,323 | 840 | 3,163 |
| Income taxes | 4,563 | (504) | 4,059 | 4,665 | (651) | 4,014 |
| Short-term debt | 3,066 | | 3,066 | 3,122 | | 3,122 |
| Long-term debt | 19,891 | 1,750 | 21,641 | 19,287 | 1,750 | 21,037 |
| Other liabilities | 13,760 | 736 | 14,496 | 13,790 | 614 | 14,404 |
| Separate account liabilities | 182,621 | | 182,621 | 174,074 | | 174,074 |
| Total liabilities | 399,691 | 64,664 | 464,355 | 390,583 | 63,891 | 454,474 |
| **COMMITMENTS AND CONTINGENT LIABILITIES** | | | | | | |
| **EQUITY** | | | | | | |
| Accumulated other comprehensive income(loss) | 403 | 217 | 620 | (574) | 131 | (443) |
| Other attributed equity | 25,318 | 1,062 | 26,380 | 24,728 | 910 | 25,638 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Total attributed equity | 25,721 | 1,279 | 27,000 | 24,154 | 1,041 | 25,195 |
| Noncontrolling interests | 506 | | 506 | 534 | | 534 |
| Total equity | 26,227 | 1,279 | 27,506 | 24,688 | 1,041 | 25,729 |
| **TOTAL LIABILITIES AND EQUITY** | $ 425,918 | $ 65,943 | $ 491,861 | $ 415,271 | $ 64,932 | $ 480,203 |

*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 March 31, 2010 and 2009 (in millions)**

| | Three Months Ended March 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2010 | | | 2009 | | |
| | Financial Services Businesses | Closed Block Business | Consolidated | Financial Services Businesses | Closed Block Business | Consolidated |
| **REVENUES** | | | | | | |
| Premiums | $ 3,531 | $ 711 | $ 4,242 | $ 3,261 | $ 773 | $ 4,034 |
| Policy charges and fee income | 816 | | 816 | 726 | | 726 |
| Net investment income | 2,074 | 800 | 2,874 | 2,062 | 787 | 2,849 |
| Asset management fees and other income | 964 | 7 | 971 | 763 | 15 | 778 |
| Realized investment gains (losses), net | | | | | | |
| Other-than-temporary impairments on fixed maturity securities | (758) | (491) | (1,249) | (1,082) | (773) | (1,855) |
| Other-than-temporary impairments on fixed maturity securities transferred to Other Comprehensive Income | 542 | 453 | 995 | 658 | 592 | 1,250 |
| Other realized investment gains (losses), net | 331 | 312 | 643 | 997 | (254) | 743 |
| Total realized investment gains (losses), net | 115 | 274 | 389 | 573 | (435) | 138 |
| Total revenues | 7,500 | 1,792 | 9,292 | 7,385 | 1,140 | 8,525 |
| **BENEFITS AND EXPENSES** | | | | | | |
| Policyholders benefits | 3,403 | 840 | 4,243 | 3,429 | 912 | 4,341 |
| Interest credited to policyholders account balances | 1,200 | 35 | 1,235 | 1,134 | 35 | 1,169 |
| Dividends to policyholders | 26 | 491 | 517 | (4) | 3 | (1) |
| General and administrative expenses | 2,114 | 167 | 2,281 | 2,853 | 160 | 3,013 |
| Total benefits and expenses | 6,743 | 1,533 | 8,276 | 7,412 | 1,110 | 8,522 |
| **INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES** | 757 | 259 | 1,016 | (27) | 30 | 3 |
| Income tax expense (benefit) | 255 | 98 | 353 | (13) | 11 | (2) |
| **INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES** | 502 | 161 | 663 | (14) | 19 | 5 |
| Equity in earnings of operating joint ventures, net of taxes | 10 | | 10 | (6) | | (6) |
| | 512 | 161 | 673 | (20) | 19 | (1) |

| | | | | | | |
|---|---|---|---|---|---|---|
| **INCOME (LOSS) FROM CONTINUING OPERATIONS** | | | | | | |
| Income (loss) from discontinued operations, net of taxes | (2) | | (2) | 4 | | 4 |
| **NET INCOME (LOSS)** | 510 | 161 | 671 | (16) | 19 | 3 |
| Less: Loss attributable to noncontrolling interests | (26) | | (26) | (11) | | (11) |
| **NET INCOME (LOSS) ATTRIBUTABLE TO PRUDENTIAL FINANCIAL, INC.** | $ 536 | $ 161 | $ 697 | $ (5) | $ 19 | $ 14 |

*See Notes to Unaudited Interim Supplemental Combining Financial Information*

**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 and Investments divisions and Corporate and Other operations.

**2. ALLOCATION OF RESULTS**

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

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

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.

**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 March 31, 2010, compared with December 31, 2009, and its consolidated results of operations for the three months ended March 31, 2010 and 2009. 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, the statements under Forward-Looking Statements and the audited Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2009, 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 seven 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 and Investments division consists of our International Insurance and International Investments segments. Our Corporate and Other operations include our real estate and relocation services business, as well as corporate items and initiatives that are not allocated to business segments. Corporate and Other operations also include businesses that have been or will be divested and businesses that we have placed in wind-down status.

We attribute financing costs to each segment based on the amount of financing used by each segment, excluding financing costs associated with corporate debt 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 internally and through acquisitions, joint ventures or other forms of business combinations or investments. Our principal acquisition focus is in our current business lines, both domestic and international.

### Closed Block Business

In connection with the demutualization, we ceased offering domestic participating products. The liabilities for our traditional domestic in force participating products were segregated, together with assets, in a regulatory mechanism referred to as the Closed Block. The Closed Block is designed generally to provide for the reasonable expectations for future policy dividends after demutualization of holders of participating individual life insurance policies and annuities included in the Closed Block by allocating assets that will be used exclusively for payment of benefits, including policyholder dividends, expenses and taxes with respect to these products. See Note 6 to the Unaudited Interim Consolidated Financial Statements for more information on the Closed Block. At the time of demutualization, we determined the amount of Closed Block assets so that the Closed Block assets initially had a lower book value than the Closed Block liabilities. We expect that the Closed

Block assets will generate sufficient cash flow, together with anticipated revenues from the Closed Block policies, over the life of the Closed Block to fund payments of all expenses, taxes, and policyholder benefits to be paid to, and the reasonable dividend expectations of, holders of the Closed Block policies. We also segregated for accounting purposes the assets that we need to hold outside the Closed Block to meet capital requirements related to the Closed Block policies. No policies sold after demutualization will be added to the Closed Block, and its in force business is expected to ultimately decline as we pay policyholder benefits in full. We also expect the proportion of our business represented by the Closed Block to decline as we grow other businesses.

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

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

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

**Executive Summary**

Prudential Financial, a financial services leader with approximately $693 billion of assets under management as of March 31, 2010, 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, investment management, and real estate services. We offer these products and services to individual and institutional customers through one of the largest distribution networks in the financial services industry.

Our financial condition and results of operations for the three months ended March 31, 2010 reflect the following:

- Net income of our Financial Services Businesses attributable to Prudential Financial, Inc. for the three months ended March 31, 2010 was $536 million.

- Pre-tax net realized investment losses and related adjustments of the Financial Services Businesses in the first quarter of 2010 were $55 million, primarily reflecting other-than-temporary impairments of fixed maturity and equity securities of $282 million, partially

offset by net increases in the fair value of derivatives used in investment duration management and hedging programs.

Net unrealized gains on general account fixed maturity investments of the Financial Services Businesses amounted to $2.429 billion as of March 31, 2010, compared to net unrealized gains of $998 million as of December 31, 2009. Gross unrealized gains increased from $5.387 billion as of December 31, 2009 to $6.131 billion as of March 31, 2010 and gross unrealized losses decreased from $4.389 billion to $3.702

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billion for the same periods as credit spreads tightened across most asset classes and other-than-temporary impairments were recognized, while risk-free rates remained relatively flat. Net unrealized gains on general account fixed maturity investments of the Closed Block Business amounted to $620 million as of March 31, 2010, compared to net unrealized gains of $7 million as of December 31, 2009.

Individual Annuity total account value as of March 31, 2010 was at a record high. Individual Annuity gross sales in the first quarter of 2010 were $4.9 billion, an increase from $2.2 billion in the prior year quarter, and net sales in the first quarter of 2010 were $3.2 billion, an increase from $643 million in the prior year quarter.

Full Service Retirement continued to have net additions, reflecting gross deposits and sales of $5.6 billion and net additions of $1.1 billion in the first quarter of 2010, compared to gross deposits and sales of $10.5 billion and net additions of $6.3 billion in the prior year quarter.

We also continued to have positive net flows in our asset management business, as well as solid sales in our domestic insurance businesses and record-high sales in our international insurance business in the first quarter of 2010.

As of March 31, 2010, Prudential Financial, the parent holding company, had cash and short-term investments of $3.459 billion.

**Results of Operations**