PRUDENTIAL FINANCIAL INC
Form 10-Q
November 02, 2006
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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 September 30, 2006

OR

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

For the Transition Period from to

Commission File Number 001-16707

Prudential Financial, Inc.

(Exact Name of Registrant as Specified in its Charter)

New Jersey	**22-3703799**
(State or Other Jurisdiction of	**(I.R.S. Employer**
Incorporation or Organization)	**Identification Number)**

751 Broad Street

Newark, New Jersey 07102

(973) 802-6000

(Address and Telephone Number of Registrant s Principal Executive Offices)

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

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

Large accelerated filer x	Accelerated filer ¨	Non-accelerated filer ¨

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

As of September 30, 2006, 477 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 stock, real estate and other financial markets; (2) interest rate fluctuations; (3) reestimates of our reserves for future policy benefits and claims; (4) differences between actual experience regarding mortality, morbidity, persistency, surrender experience, interest rates or market returns and the assumptions we use in pricing our products, establishing liabilities and reserves or for other purposes; (5) changes in our assumptions related to deferred policy acquisition costs, valuation of business acquired or goodwill; (6) changes in our claims-paying or credit ratings; (7) investment losses and defaults; (8) competition in our product lines and for personnel; (9) changes in tax law; (10) economic, political, currency and other risks relating to our international operations; (11) fluctuations in foreign currency exchange rates and foreign securities markets; (12) regulatory or legislative changes; (13) adverse determinations in litigation or regulatory matters and our exposure to contingent liabilities, including in connection with our divestiture or winding down of businesses; (14) domestic or international military actions, natural or man-made disasters including terrorist activities or pandemic disease, or other events resulting in catastrophic loss of life; (15) ineffectiveness of risk management policies and procedures in identifying, monitoring and managing risks; (16) effects of acquisitions, divestitures and restructurings, including possible difficulties in integrating and realizing the projected results of acquisitions; (17) changes in statutory or U.S. GAAP accounting principles, practices or policies; (18) changes in assumptions for retirement expense; (19) Prudential Financial, Inc. s primary reliance, as a holding company, on dividends or distributions from its subsidiaries to meet debt payment obligations and continue share repurchases, and the applicable regulatory restrictions on the ability of the subsidiaries to pay such dividends or distributions; and (20) risks due to the lack of legal separation between our Financial Services Businesses and our Closed Block Business. Prudential Financial, Inc. does not intend, and is under no obligation, to update any particular forward-looking statement included in this document. See Risk Factors included in the Annual Report on Form 10-K for the year ended December 31, 2005 for discussion of certain risks relating to our businesses and investment in our securities.

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

PART I FINANCIAL INFORMATION

ITEM 1. ***Financial Statements***

PRUDENTIAL FINANCIAL, INC.

Unaudited Interim Consolidated Statements of Financial Position

September 30, 2006 and December 31, 2005 (in millions, except share amounts)

	September 30, 2006	December 31, 2005
ASSETS		
Fixed maturities:		
Available for sale, at fair value (amortized cost: 2006 $153,934; 2005 $148,706)	$ 158,077	$ 154,434
Held to maturity, at amortized cost (fair value: 2006 $3,400; 2005 $3,228)	3,473	3,249
Trading account assets supporting insurance liabilities, at fair value	14,453	13,781
Other trading account assets, at fair value	1,933	1,443
Equity securities, available for sale, at fair value (cost: 2006 $5,448; 2005 $4,951)	6,410	5,843
Commercial loans	25,382	24,441
Policy loans	8,757	8,370
Securities purchased under agreements to resell	187	413
Other long-term investments	5,761	5,468
Short-term investments	4,478	3,959
Total investments	228,911	221,401
Cash and cash equivalents	9,567	7,799
Accrued investment income	2,235	2,067
Reinsurance recoverables	1,908	3,548
Deferred policy acquisition costs	10,570	9,438
Other assets	18,347	15,962
Separate account assets	175,363	157,561
TOTAL ASSETS	$ 446,901	$ 417,776
LIABILITIES AND STOCKHOLDERS EQUITY		
LIABILITIES		
Future policy benefits	$ 105,872	$ 102,039
Policyholders account balances	80,988	75,492
Policyholders dividends	3,891	4,413
Reinsurance payables	1,405	3,069
Securities sold under agreements to repurchase	12,046	12,517
Cash collateral for loaned securities	6,915	5,818
Income taxes payable	2,954	2,214

Securities sold but not yet purchased	313	223
Short-term debt	10,765	11,114
Long-term debt	9,214	8,270
Other liabilities	13,977	12,283
Separate account liabilities	175,363	157,561
Total liabilities	423,703	395,013
COMMITMENTS AND CONTINGENT LIABILITIES (See Note 10)		
STOCKHOLDERS EQUITY		
Preferred Stock ($.01 par value; 10,000,000 shares authorized; none issued)		
Common Stock ($.01 par value; 1,500,000,000 shares authorized; 604,900,213 and 604,899,046 shares issued as of September 30, 2006 and December 31, 2005, respectively)	6	6
Class B Stock ($.01 par value; 10,000,000 shares authorized; 2,000,000 shares issued and outstanding as of September 30, 2006 and December 31, 2005, respectively)		
Additional paid-in capital	20,592	20,501
Common Stock held in treasury, at cost (127,597,557 and 107,405,004 shares as of September 30, 2006 and December 31, 2005, respectively)	(6,597)	(4,925)
Accumulated other comprehensive income	894	1,234
Retained earnings	8,303	5,947
Total stockholders equity	23,198	22,763
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 446,901	$ 417,776

See Notes to Unaudited Interim Consolidated Financial Statements

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PRUDENTIAL FINANCIAL, INC.

Unaudited Interim Consolidated Statements of Operations

Three and Nine Months Ended September 30, 2006 and 2005 (in millions, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	**2005**	**2006**	**2005**
REVENUES				
Premiums	$ 3,364	$ 3,399	$ 10,331	$ 10,316
Policy charges and fee income	583	662	1,921	1,891
Net investment income	2,871	2,665	8,381	7,792
Realized investment gains (losses), net	389	230	246	1,223
Asset management fees and other income	1,269	835	2,944	2,623
Total revenues	8,476	7,791	23,823	23,845
BENEFITS AND EXPENSES				
Policyholders benefits	3,516	3,381	10,631	10,399
Interest credited to policyholders account balances	918	642	2,123	1,998
Dividends to policyholders	729	695	1,877	2,025
General and administrative expenses	1,765	1,955	5,939	5,674
Total benefits and expenses	6,928	6,673	20,570	20,096
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	1,548	1,118	3,253	3,749
Income tax expense (benefit)	411	(261)	908	520
INCOME FROM CONTINUING OPERATIONS	1,137	1,379	2,345	3,229
Income (loss) from discontinued operations, net of taxes	68	(15)	46	(53)
NET INCOME	$ 1,205	$ 1,364	$ 2,391	$ 3,176
EARNINGS PER SHARE (See Note 6)				
Financial Services Businesses				
Basic:				
Income from continuing operations per share of Common Stock	$ 2.29	$ 2.66	$ 4.62	$ 5.73
Income (loss) from discontinued operations, net of taxes	0.14	(0.03)	0.10	(0.10)
Net income per share of Common Stock	$ 2.43	$ 2.63	$ 4.72	$ 5.63
Diluted:				
Income from continuing operations per share of Common Stock	$ 2.24	$ 2.62	$ 4.53	$ 5.64
Income (loss) from discontinued operations, net of taxes	0.14	(0.03)	0.09	(0.10)

Net income per share of Common Stock	$ 2.38	$ 2.59	$ 4.62	$ 5.54
Closed Block Business				
Net income per share of Class B Stock basic and diluted	$ 18.50	$ 11.50	$ 44.50	$ 135.50

See Notes to Unaudited Interim Consolidated Financial Statements

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PRUDENTIAL FINANCIAL, INC.

Unaudited Interim Consolidated Statement of Stockholders Equity

Nine Months Ended September 30, 2006 (in millions)

	Common Stock	Class B Stock	Additional Paid-in Capital	Retained Earnings	Common Stock Held In Treasury	Accumulated Other Comprehensive Income / (Loss)	Total Stockholders Equity
Balance, December 31, 2005	$ 6	$	$ 20,501	$ 5,947	$ (4,925)	$ 1,234	$ 22,763
Common Stock acquired					(1,873)		(1,873)
Stock-based compensation programs			91	(35)	201		257
Comprehensive income (loss):							
Net income				2,391			2,391
Other comprehensive loss, net of taxes						(340)	(340)
Total comprehensive income							2,051
Balance, September 30, 2006	$ 6	$	$ 20,592	$ 8,303	$ (6,597)	$ 894	$ 23,198

See Notes to Unaudited Interim Consolidated Financial Statements

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PRUDENTIAL FINANCIAL, INC.

Unaudited Interim Consolidated Statements of Cash Flows

Nine Months Ended September 30, 2006 and 2005 (in millions)

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 2,391	$ 3,176
Adjustments to reconcile net income to net cash provided by operating activities:		
Realized investment (gains) losses, net	(246)	(1,223)
Policy charges and fee income	(511)	(620)
Interest credited to policyholders account balances	2,123	1,998
Depreciation and amortization, including premiums and discounts	272	447
Change in:		
Deferred policy acquisition costs	(1,011)	(542)
Future policy benefits and other insurance liabilities	1,917	1,917
Trading account assets supporting insurance liabilities and other trading account assets	(1,059)	(1,033)
Income taxes payable	698	404
Securities sold but not yet purchased	(58)	(220)
Other, net	(2,495)	(365)
Cash flows from operating activities	2,021	3,939
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from the sale/maturity/prepayment of:		
Fixed maturities, available for sale	72,303	68,842
Fixed maturities, held to maturity	228	454
Equity securities, available for sale	3,039	2,206
Commercial loans	3,580	3,871
Policy loans	963	993
Other long-term investments	1,371	670
Short-term investments	8,924	10,619
Payments for the purchase of:		
Fixed maturities, available for sale	(75,765)	(76,307)
Fixed maturities, held to maturity	(461)	(994)
Equity securities, available for sale	(3,242)	(2,434)
Commercial loans	(4,461)	(3,216)
Policy loans	(1,089)	(843)
Other long-term investments	(925)	(391)
Short-term investments	(9,264)	(10,262)
Acquisition of businesses, net of cash acquired	724	
Other, net	111	(150)
Cash flows used in investing activities	(3,964)	(6,942)
CASH FLOWS FROM FINANCING ACTIVITIES		
Policyholders account deposits	17,505	15,298
Policyholders account withdrawals	(15,392)	(14,700)
Net change in securities sold under agreements to repurchase and cash collateral for loaned securities	2,584	253
Cash dividends paid on Common Stock	(53)	(44)
Net change in financing arrangements (maturities 90 days or less)	(459)	2,942
Common Stock acquired	(1,855)	(1,453)
Common Stock reissued for exercise of stock options	117	132
Proceeds from the issuance of debt (maturities longer than 90 days)	2,357	1,876
Repayments of debt (maturities longer than 90 days)	(1,058)	(782)

Cash payments to or in respect of eligible policyholders	(93)	(135)
Excess tax benefits from share-based payment arrangements	51	
Other, net		
Cash flows from financing activities	3,704	3,387
Effect of foreign exchange rate changes on cash balances	7	(80)
NET INCREASE IN CASH AND CASH EQUIVALENTS	1,768	304
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	7,799	8,072
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 9,567	$ 8,376

See Notes to Unaudited Interim Consolidated Financial Statements

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

Basis of Presentation

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

In the opinion of management, all adjustments necessary for a fair statement of the financial position and results of operations have been made. All such adjustments are of a normal, recurring nature. Interim results are not necessarily indicative of the results that may be expected for the full year. These financial statements should be read in conjunction with the Company s audited Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005.

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 at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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

Reclassifications

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

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

2. ACCOUNTING POLICIES AND PRONOUNCEMENTS

Accounting Pronouncements Adopted

In November 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) FAS 115-1 and FAS 124-1, The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments. This FSP provides impairment models for determining whether to record impairment losses associated with investments in certain equity and debt securities, primarily by referencing existing accounting guidance. It also requires income to be accrued on a level-yield basis following an impairment of debt securities, where reasonable estimates of the timing and amount of future cash flows can be made. The Company adopted this guidance effective January 1, 2006, and it did not have a material effect on the Company s consolidated results of operations.

In June 2005, the Emerging Issues Task Force (EITF) of the FASB reached a consensus on Issue No. 04-5, Investor s Accounting for an Investment in a Limited Partnership When the Investor Is the Sole General Partner and the Limited Partners Have Certain Rights. This Issue first presumes that general partners in a limited partnership control that partnership and should therefore consolidate that partnership, and then provides that the general partners may overcome the presumption of control if the limited partners have: (1) the substantive ability to dissolve or liquidate the limited partnership, or otherwise to remove the general partners without cause or (2) the ability to participate effectively in significant decisions that would be expected to be made in the ordinary course of the limited partnership s business. This guidance became effective for new or amended arrangements after June 29, 2005, and became effective January 1, 2006 for all arrangements existing as of June 29, 2005 that remain unmodified. The Company s adoption of this guidance did not have a material effect on the Company s consolidated financial position or results of operations.

In June 2005, the FASB issued Statement No. 133 Implementation Issue No. B39, Embedded Derivatives: Application of Paragraph 13(b) to Call Options That are Exercisable Only by the Debtor. Implementation Issue No. B39 indicates that debt instruments where the right to accelerate the settlement of debt can be exercised only by the debtor do not meet the criteria of Paragraph 13(b) of Statement No. 133, and therefore should not individually lead to such options being considered embedded derivatives. Such options must still be evaluated under paragraph 13(a) of Statement No. 133. This implementation guidance is effective for the first fiscal quarter beginning after December 15, 2005. The Company s adoption of this guidance effective January 1, 2006 did not have a material effect on the Company s consolidated financial position or results of operations as the guidance is consistent with the Company s existing accounting policy.

Adoption of Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment

The Company adopted SFAS No. 123(R), Share-Based Payment on January 1, 2006. This standard requires that the cost resulting from all share-based payments be recognized in the financial statements and requires all entities to apply the fair value based measurement method in accounting for share-based payment transactions with employees except for equity instruments held by employee share ownership plans. As described more fully below, the Company had previously adopted the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation, as amended, prospectively for all new stock options granted to employees on or after January 1, 2003. Upon adoption of SFAS No. 123(R), there were no unvested stock options issued prior to January 1, 2003, and, therefore, the adoption of SFAS No. 123(R) had no impact to the Company s consolidated financial condition or results of operations. Upon the adoption of SFAS No. 123(R), the Company revised its approach to the recognition of compensation costs for awards granted to retirement-eligible employees and awards that vest when an employee becomes retirement-eligible, as described more fully below.

The Company issues employee share-based compensation awards, under a plan authorized by the Board of Directors, that are subject to specific vesting conditions; generally the awards vest ratably over a three-year

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

period, the nominal vesting period, or at the date the employee retires (as defined by the plan), if earlier. For awards granted prior to January 1, 2006 that specify an employee vests in the award upon retirement, the Company accounts for those awards using the nominal vesting period approach. Under this approach, the Company records compensation expense over the nominal vesting period. If the employee retires before the end of the nominal vesting period, any remaining unrecognized compensation cost is recognized at the date of retirement.

Upon the adoption of SFAS No. 123(R), the Company revised its approach to apply the non-substantive vesting period approach to all new share-based compensation awards granted after January 1, 2006. Under this approach, all compensation cost is recognized on the date of grant for awards issued to retirement-eligible employees, or over the period from the grant date to the date retirement eligibility is achieved, if that is expected to occur during the nominal vesting period. The Company continues to apply the nominal vesting period approach for the portion of unvested outstanding awards issued prior to the adoption of SFAS No. 123(R).

If the Company had accounted for all share-based compensation awards granted after January 1, 2003 under the non-substantive vesting period approach, net income of the Financial Services Businesses for the three and nine months ended September 30, 2006 would have been increased by $3 million, or $0.01 per share of Common Stock, on both a basic and diluted basis, and $9 million, or $0.02 per share of Common Stock, on both a basic and diluted basis, respectively. Net income of the Financial Services Businesses for the three and nine months ended September 30, 2005 would have been decreased by $2 million, with no reportable impact to the earnings per share of Common Stock, on both a basic and diluted basis, and $8 million, or $0.02 per share of Common Stock, on both a basic and diluted basis, respectively.

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

As noted above, effective January 1, 2003, the Company changed its accounting for employee stock options to adopt the fair value recognition provisions of SFAS No. 123, as amended, prospectively for all new stock options granted to employees on or after January 1, 2003. Prior to January 1, 2003, the Company accounted for employee stock options using the intrinsic value method of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Under this method, the Company did not recognize any stock-based compensation expense for employee stock options as all options granted had an exercise price equal to the market value of the underlying Common Stock on the date of grant. If the Company had accounted for all employee stock options granted prior to January 1, 2003 under the fair value-based measurement method of SFAS No. 123, net income and earnings per share for the three and nine months ended September 30, 2006 would have been unchanged, since, as of January 1, 2006, there were no unvested employee stock options issued prior to January 1, 2003. Net income and earnings per share for the three and nine months ended September 30, 2005, would have been as follows:

	Three Months Ended September 30, 2005		Nine Months Ended September 30, 2005	
	Financial Services Businesses	Closed Block Business	Financial Services Businesses	Closed Block Business
	(in millions, except per share amounts)			
Net income, as reported	$ 1,322	$ 42	$ 2,842	$ 334
Add: Total employee stock option compensation expense included in reported net income, net of taxes	8		22	
Deduct: Total employee stock option compensation expense determined under the fair value based method for all awards, net of taxes	(9)		(32)	
Pro forma net income	$ 1,321	$ 42	$ 2,832	$ 334
Earnings per share:				
Basic as reported	$ 2.63	$ 11.50	$ 5.63	$ 135.50
Basic pro forma	$ 2.63	$ 11.50	$ 5.61	$ 135.50
Diluted as reported	$ 2.59	$ 11.50	$ 5.54	$ 135.50
Diluted pro forma	$ 2.59	$ 11.50	$ 5.52	$ 135.50

The fair value of each option issued prior to January 1, 2003 for purposes of the pro forma information presented above was estimated on the date of grant using a Black-Scholes option-pricing model. For options issued on or after January 1, 2003, the fair value of each option was estimated on the date of grant using a binomial option-pricing model.

The Company accounts for non-employee stock options using the fair value method in accordance with EITF No. 96-18 Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services and related interpretations in accounting for its non-employee stock options.

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106 and 132(R). This statement

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

requires an employer on a prospective basis to recognize the overfunded or underfunded status of its defined benefit pension and postretirement plans as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. This requirement, along with the required disclosures, is effective for fiscal years ending after December 15, 2006. The Company is still in the process of assessing the impact of recognizing the funded status of its plans, but currently anticipates recording a net after-tax reduction to Accumulated other comprehensive income within stockholders equity of approximately $500 million as of December 31, 2006.

SFAS No. 158 also requires an employer on a prospective basis to measure the funded status of its plans as of its fiscal year-end, and is effective for fiscal years ending after December 15, 2008. The Company is currently assessing the impact that changing from a September 30 measurement date to a December 31 measurement date will have on the Company s consolidated financial position and results of operations.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and requires additional disclosures about fair value measurements. This Statement does not require any new fair value measurements, but the application of this Statement could change current practices in determining fair value. The Company plans to adopt this guidance effective January 1, 2008. The Company is currently assessing the impact of SFAS No. 157 on the Company s consolidated financial position and results of operations.

In September 2006, the staff of the SEC issued Staff Accounting Bulletin (SAB) No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements.

The interpretations in this SAB express the staff s views regarding the process of quantifying financial statement misstatements. Specifically, the SEC staff believes that registrants must quantify the impact on current period financial statements of correcting all misstatements, including both those occurring in the current period and the effect of reversing those that have accumulated from prior periods. This SAB should be applied beginning with the first fiscal year ending after November 15, 2006, with early adoption encouraged. Since the Company s method for quantifying financial statement misstatements already considers those occurring in the current period and the effect of reversing those that have accumulated from prior periods, the adoption of SAB No. 108 should have no effect to the financial position and result of operations of the Company.

In July 2006, the FASB issued FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109. This Interpretation prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that a company has taken or expects to take on a tax return. This Interpretation is effective for fiscal years beginning after December 15, 2006. The Company will adopt FIN No. 48 on January 1, 2007. The Company is currently assessing the impact of FIN No. 48 on the Company s consolidated financial position, results of operations and notes to the consolidated financial statements.

In July 2006, the FASB issued FSP No. 13-2, Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction an amendment of FASB Statement No. 13. This Staff Position indicates that a change or projected change in the timing of cash flows relating to income taxes generated by a leveraged lease would require a recalculation of cumulative and prospective income recognition associated with the transaction. The FSP is effective for fiscal years beginning after December 15, 2006. The Company will adopt FSP No. 13-2 on January 1, 2007. The Company currently estimates that the impact of adopting FSP No. 13-2 will be a net after-tax reduction to retained earnings of $75 million, as of January 1, 2007.

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets. This statement requires that servicing assets or liabilities are to be initially measured at fair value, with subsequent changes in value reported based on either a fair value or amortized cost approach. Under the previous guidance,

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

such servicing assets or liabilities were initially measured at historical cost and the amortized cost method was required for subsequent reporting. The Company plans to adopt this guidance effective January 1, 2007. The Company is currently assessing the impact of SFAS No. 156 on the Company s consolidated financial position and results of operations.

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Instruments. This statement provides an election, on an instrument by instrument basis, to measure at fair value an entire hybrid financial instrument that contains an embedded derivative requiring bifurcation, rather than measuring only the embedded derivative on a fair value basis. This statement also removes an exception from the requirement to bifurcate an embedded derivative feature from a beneficial interest in securitized financial assets. The Company has used this exception for investments the Company has made in securitized financial assets in the normal course of operations, and thus has not previously had to consider whether such investments contain an embedded derivative. The new requirement to identify embedded derivatives in beneficial interests will be applied on a prospective basis only to beneficial interests acquired, issued, or subject to certain remeasurement conditions after the adoption date of the new guidance. The Company plans to adopt this guidance effective January 1, 2007. The Company is in the process of determining whether there are any hybrid instruments for which the Company will elect the fair value option.

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

3. ACQUISITIONS AND DISPOSITIONS

Acquisition of The Allstate Corporation s Variable Annuity Business

On June 1, 2006 (the date of acquisition), the Company acquired the variable annuity business of The Allstate Corporation (Allstate) through a reinsurance transaction for $635 million of total consideration, consisting primarily of a $628 million ceding commission. The reinsurance arrangements with Allstate include a coinsurance arrangement associated with the general account liabilities assumed and a modified coinsurance arrangement associated with the separate account liabilities assumed. The assets acquired and liabilities assumed have been included in the Company s consolidated financial statements as of the date of acquisition. The Company s results of operations include the results of the acquired variable annuity business beginning from the date of acquisition. The assets acquired included primarily cash of $1.4 billion that was subsequently used to purchase investments; valuation of business acquired (VOBA) of $648 million that represents the present value of future profits embedded in the acquired contracts; and $97 million of goodwill. The liabilities assumed consisted primarily of variable annuity contractholders account balances of $1.5 billion associated with the coinsurance agreement. The assets acquired and liabilities assumed also included a reinsurance receivable from Allstate and a reinsurance payable to Allstate, each in the amount of $14.8 billion. The reinsurance payable, which represents the Company s obligation under the modified coinsurance arrangement, is netted with the

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reinsurance receivable in the Company s Statement of Financial Position. Pro forma information for this acquisition is omitted as the impact is not material.

Acquisition of CIGNA Corporation s (CIGNA) Retirement Business

The Company acquired the retirement business of CIGNA for cash consideration of $2.1 billion on April 1, 2004 and the results of this business have been included in the Company s consolidated results since the date of acquisition. As an element of the acquisition, the Company had the right, beginning two years after the acquisition, to commute the modified-coinsurance-with-assumption arrangement related to the acquired defined benefit guaranteed-cost contracts in exchange for cash consideration from CIGNA. Effective April 1, 2006, the Company reached an agreement with CIGNA to convert the modified-coinsurance-with-assumption arrangement to an indemnity coinsurance arrangement, effectively retaining the economics of the defined benefit guaranteed-cost contracts for the life of the block of business. Upon conversion, the Company extinguished its reinsurance receivable and payable with CIGNA related to the modified-coinsurance-with-assumption arrangement. Concurrently, the Company assumed $1.7 billion of liabilities from CIGNA under the indemnity coinsurance arrangement and received the related assets.

Discontinued Operations

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	**2005**	**2006**	**2005**
		(in millions)		
Sold real estate investments	$ 96	$	$ 96	$
Canadian IWP and IH operations	(5)	(1)	(11)	2
Philippine insurance operations	2		(13)	
Dryden Wealth Management	1	(16)	(3)	(66)
International securities operations	(4)	(1)	(9)	(13)
Healthcare operations	10		10	18
Income (loss) from discontinued operations before income taxes	100	(18)	70	(59)
Income tax expense (benefit)	32	(3)	24	(6)
Income (loss) from discontinued operations, net of taxes	$ 68	$ (15)	$ 46	$ (53)

The Company s Unaudited Interim Consolidated Statements of Financial Position include total assets and total liabilities related to discontinued businesses of $290 million and $125 million, respectively, as of September 30, 2006 and $699 million and $436 million, respectively, as of December 31, 2005. Charges recorded in connection with the disposals of businesses include estimates that are subject to subsequent adjustment. It is possible that such adjustments might be material to future net results of operations of a particular quarterly or annual period.

Discontinued operations activity includes a gain on the sale of a wholly-owned real estate property; the completion of the sale of the Company s Philippine insurance operations; and the completion of a reinsurance transaction related to the Company s Canadian Intermediate Weekly Premium (IWP) and Individual Health (IH) operations, all of which occurred during the third quarter of 2006.

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4. CLOSED BLOCK

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

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

The excess of Closed Block Liabilities over Closed Block Assets at the date of the demutualization (adjusted to eliminate the impact of related amounts in Accumulated other comprehensive income (loss)) represented the estimated maximum future earnings at that date from the Closed Block expected to result from operations attributed to the Closed Block after income taxes. In establishing the Closed Block, the Company developed an actuarial calculation of the timing of such maximum future earnings. If actual cumulative earnings of the Closed Block from inception through the end of any given period are greater than the expected cumulative earnings, only the expected earnings will be recognized in income. Any excess of actual cumulative earnings over expected cumulative earnings will represent undistributed accumulated earnings attributable to policyholders, which are recorded as a policyholder dividend obligation. The policyholder dividend obligation represents amounts to be paid to Closed Block policyholders as an additional policyholder dividend unless otherwise offset by future Closed Block performance that is less favorable than originally expected. If the actual cumulative earnings of the Closed Block from its inception through the end of any given period are less than the expected cumulative earnings of the Closed Block, the Company will recognize only the actual earnings in income. However, the Company may reduce policyholder dividend scales in the future, which would be intended to increase future actual earnings until the actual cumulative earnings equaled the expected cumulative earnings. At September 30, 2006, the Company recognized a policyholder dividend obligation of $360 million to Closed Block policyholders for the excess of actual cumulative earnings over the expected cumulative earnings. Additionally, net unrealized investment gains that have arisen subsequent to the establishment of the Closed Block were reflected as a policyholder dividend obligation of $1.809 billion at September 30, 2006 to be paid to Closed Block policyholders unless otherwise offset by future experience, with an offsetting amount reported in Accumulated other comprehensive income (loss).

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

	September 30, 2006	December 31, 2005
	(in millions)	
Closed Block Liabilities		
Future policy benefits	$ 50,448	$ 50,112
Policyholders dividends payable	1,175	1,089
Policyholder dividend obligation	2,169	2,628
Policyholders account balances	5,559	5,568
Other Closed Block liabilities	10,770	9,676
Total Closed Block Liabilities	70,121	69,073
Closed Block Assets		
Fixed maturities, available for sale, at fair value	45,749	45,403
Equity securities, available for sale, at fair value	3,432	3,128
Commercial loans	6,731	6,750
Policy loans	5,407	5,403
Other long-term investments	888	923
Short-term investments	1,701	1,340
Total investments	63,908	62,947
Cash and cash equivalents	2,078	2,167
Accrued investment income	713	658
Other Closed Block assets	406	286
Total Closed Block Assets	67,105	66,058
Excess of reported Closed Block Liabilities over Closed Block Assets	3,016	3,015
Portion of above representing accumulated other comprehensive income:		
Net unrealized investment gains	1,859	2,402
Allocated to policyholder dividend obligation	(1,809)	(2,302)
Future earnings to be recognized from Closed Block Assets and Closed Block Liabilities	$ 3,066	$ 3,115

Information regarding the policyholder dividend obligation is as follows:

	Nine Months Ended September 30, 2006
	(in millions)
Balance, January 1, 2006	$ 2,628
Impact on income before gains allocable to policyholder dividend obligation	34
Change in unrealized investment gains	(493)
Balance, September 30, 2006	$ 2,169

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

Closed Block revenues and benefits and expenses were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
	(in millions)			
Revenues				
Premiums	$ 814	$ 822	$ 2,617	$ 2,631
Net investment income	844	864	2,544	2,575
Realized investment gains (losses), net	160	87	196	499
Other income	11	15	38	41
Total Closed Block revenues	1,829	1,788	5,395	5,746
Benefits and Expenses				
Policyholders benefits	894	912	2,898	2,930
Interest credited to policyholders account balances	34	35	105	103
Dividends to policyholders	697	666	1,803	1,856
General and administrative expenses	176	176	545	538
Total Closed Block benefits and expenses	1,801	1,789	5,351	5,427
Closed Block revenues, net of Closed Block benefits and expenses, before income taxes	28	(1)	44	319
Income tax expense (benefit)	28	(18)	(5)	101
Closed Block revenues, net of Closed Block benefits and expenses and income taxes	$	$ 17	$ 49	$ 218

5. STOCKHOLDERS EQUITY

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

	Common Stock			Class B Stock
	Issued	Held In Treasury	Outstanding	Issued and Outstanding
		(in millions)		
Balance, December 31, 2005	604.9	107.4	497.5	2.0
Common Stock issued				
Common Stock acquired		24.7	(24.7)	
Stock-based compensation programs(1)		(4.5)	4.5	
Balance, September 30, 2006	604.9	127.6	477.3	2.0

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

Common Stock Held in Treasury

In November 2005, Prudential Financial s Board of Directors authorized the Company to repurchase up to $2.5 billion of its outstanding Common Stock in calendar year 2006. The timing and amount of any repurchases

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under this authorization are determined by management based upon market conditions and other considerations, and the repurchases may be effected in the open market or through negotiated transactions. The 2006 stock repurchase program supersedes all previous repurchase programs. During the first nine months of 2006, the Company acquired 24.7 million shares of its Common Stock at a total cost of $1.873 billion.

Comprehensive Income

The components of comprehensive income are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	**2005**	**2006**	**2005**
	(in millions)			
Net income	$ 1,205	$ 1,364	$ 2,391	$ 3,176
Other comprehensive income (loss), net of taxes:				
Change in foreign currency translation adjustments	(59)	(81)	139	(231)
Change in net unrealized investments gains (losses)(1)	1,101	(653)	(472)	(421)
Additional pension liability adjustment	(3)		(7)	1
Other comprehensive income (loss)(2)	1,039	(734)	(340)	(651)
Comprehensive income	$ 2,244	$ 630	$ 2,051	$ 2,525

(1) Includes cash flow hedges of $7 million and $(13) million for the three months ended September 30, 2006 and 2005, respectively, and $(34) million and $(30) million for the nine months ended September 30, 2006 and 2005, respectively.

(2) Amounts are net of taxes of $517 million and $(352) million for the three months ended September 30, 2006 and 2005, respectively, and $(280) million and $(271) million for the nine months ended September 30, 2006 and 2005, respectively.

The balance of and changes in each component of Accumulated other comprehensive income for the nine months ended September 30, 2006 are as follows (net of taxes):

	Accumulated Other Comprehensive Income (Loss)			
	Foreign Currency	**Net**	**Pension Liability**	**Total**

	Translation Adjustments	Unrealized Investment Gains (Losses)(1)	Adjustment	Accumulated Other Comprehensive Income (Loss)
		(in millions)		
Balance, December 31, 2005	$ (75)	$ 1,576	$ (267)	$ 1,234
Change in component during period	139	(472)	(7)	(340)
Balance, September 30, 2006	$ 64	$ 1,104	$ (274)	$ 894

(1) Includes cash flow hedges of $(112) million and $(78) million at September 30, 2006 and December 31, 2005, respectively.

6. EARNINGS PER SHARE

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

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Notes to Unaudited Interim Consolidated Financial Statements (Continued)

Block Business. Accordingly, earnings per share is calculated separately for each of these two classes of common stock.

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

Common Stock

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

	Three Months Ended September 30,					
	2006			2005		
	Income	Weighted Average Shares	Per Share Amount	Income	Weighted Average Shares	Per Share Amount
	(in millions, except per share amounts)					
Basic earnings per share						
Income from continuing operations attributable to the Financial Services Businesses	$ 1,084			$ 1,337		
Direct equity adjustment	16			19		
Income from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment	$ 1,100	480.8	$ 2.29	$ 1,356	509.1	$ 2.66
Effect of dilutive securities and compensation programs						
Stock options		6.5			6.0	
Deferred and long-term compensation programs		3.2			3.2	

Diluted earnings per share						
Income from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment	$ 1,100	490.5	$ 2.24	$ 1,356	518.3	$ 2.62

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	Nine Months Ended September 30,					
	2006			2005		
	Income	Weighted Average Shares	Per Share Amount	Income	Weighted Average Shares	Per Share Amount
	(in millions, except per share amounts)					
Basic earnings per share						
Income from continuing operations attributable to the Financial Services Businesses	$ 2,205			$ 2,895		
Direct equity adjustment	51			63		
Income from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment	$ 2,256	487.8	$ 4.62	$ 2,958	515.8	$ 5.73
Effect of dilutive securities and compensation programs						
Stock options		6.9			5.7	
Deferred and long-term compensation programs		3.1			3.0	
Diluted earnings per share						
Income from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment	$ 2,256	497.8	$ 4.53	$ 2,958	524.5	$ 5.64

The Company s convertible senior notes provide for the Company to issue shares of its Common Stock as a component of the conversion of the notes. The notes will be dilutive to earnings per share if the average market price of the Common Stock for a particular period is above $90.00.

For the three months ended September 30, 2006 and 2005, 2.9 million and 0.6 million options, respectively, weighted for the portion of the period they were outstanding, with a weighted average exercise price of $76.13 and $57.14 per share, respectively, were excluded from the computation of diluted earnings per share because the options, based on application of the treasury stock method, were antidilutive. For the nine months ended September 30, 2006 and 2005, 2.2 million and 2.3 million options, respectively, weighted for the portion of the period they were outstanding, with a weighted average exercise price of $76.10 and $55.92 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.

Class B Stock

Net income per share of Class B Stock was $18.50 and $11.50 for the three months ended September 30, 2006 and 2005, respectively, and $44.50 and $135.50 for the nine months ended September 30, 2006 and 2005, respectively.

The net income attributable to the Closed Block Business available to holders of Class B Stock after direct equity adjustment for the three months ended September 30, 2006 and 2005 amounted to $37 million and $23 million, respectively. The direct equity adjustment resulted in a decrease in the net income attributable to the Closed Block Business applicable to holders of Class B Stock for earnings per share purposes of $16 million and $19 million for the three months ended September 30, 2006 and 2005, respectively. The net income attributable to the Closed Block Business available to holders of Class B Stock after direct equity adjustment for the nine

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

months ended September 30, 2006 and 2005 amounted to $89 million and $271 million, respectively. The direct equity adjustment resulted in a decrease in the net income attributable to the Closed Block Business applicable to holders of Class B Stock for earnings per share purposes of $51 million and $63 million for the nine months ended September 30, 2006 and 2005, respectively. For the three and nine months ended September 30, 2006 and 2005, the weighted average number of shares of Class B Stock used in the calculation of earnings per share amounted to two million. There are no potentially dilutive shares associated with the Class B Stock.

7. SHARE-BASED PAYMENTS

In March 2003, the Company s Board of Directors adopted the Prudential Financial, Inc. Omnibus Incentive Plan (as amended and restated effective October 10, 2006, the Omnibus Plan). Upon adoption of the Omnibus Plan, the Prudential Financial, Inc. Stock Option Plan previously adopted by the Company on January 9, 2001 (the Option Plan) was merged into the Omnibus Plan. The nature of stock based awards provided under the Omnibus Plan are stock options, stock appreciation rights, restricted stock shares, restricted stock units, and equity-based performance awards (performance shares). Dividend equivalents are provided on restricted stock shares, restricted stock units and performance shares. Generally, the requisite service period is the vesting period.

As of September 30, 2006, 46,507,036 authorized shares remain available for grant under the Omnibus Plan including previously authorized but unissued shares under the Option Plan.

The Company s policy is to issue shares from Common Stock held in treasury upon exercise of employee and non-employee stock options as well as for the vesting of restricted stock shares, restricted stock units, and performance shares.

Compensation Costs

Compensation cost for employee stock options is based on the fair values estimated on the grant date, while compensation cost for non-employee stock options is re-estimated at each period-end through the vesting date, using the approach and assumptions described below. Compensation cost for restricted stock shares, restricted stock units and performance shares granted to employees is measured by the share price of the underlying Common Stock at the date of grant. Compensation cost for restricted stock shares and restricted stock units granted to non-employees is measured by the share price as of the balance sheet date for unvested shares and the share price at the vesting date for vested shares.

The fair value of each stock option award is estimated on the date of grant for stock options issued to employees and the balance sheet date or vesting date for stock options issued to non-employees using a binomial option valuation model that uses the following assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Expected volatility	20.65%	23.77%	20.65%	23.77%
Expected dividend yield	1.20%	1.20%	1.20%	1.20%
Expected term	5.14 years	5.19 years	5.14 years	5.19 years
Risk-free interest rate	4.98%	4.03%	4.58%	3.74%

Expected volatilities are based on implied volatilities from traded options on the Company s Common Stock, historical volatility of the Company s Common Stock and other factors. The Company uses historical data to estimate option exercises and employee terminations within the valuation model. The expected term of options

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granted is derived from the output of the valuation model and represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

The following chart summarizes the compensation cost recognized and the related income tax benefit for stock options, restricted stock shares, restricted stock units, and performance share awards for the three and nine months ended September 30, 2006:

	Three Months Ended September 30, 2006		Nine Months Ended September 30, 2006	
	Total Compensation Cost Recognized	**Income Tax Benefit**	**Total Compensation Cost Recognized**	**Income Tax Benefit**
		(in millions)		
Employee stock options	$ 12	$ 4	$ 48	$ 17
Non-employee stock options			3	1
Employee restricted stock shares, restricted stock units, and performance shares	29	10	87	31
Non-employee restricted stock shares and restricted stock units	1		3	1
Total	$ 42	$ 14	$ 141	$ 50

Stock Options

Each stock option granted has an exercise price no less than the fair market value of the Company s Common Stock on the date of grant and has a maximum term of 10 years. Generally, one third of the option grant vests in each of the first three years. Participants are employees and non-employees (i.e., statutory agents who perform services for the Company and participating subsidiaries).

Stock options outstanding under the Omnibus Plan as of December 31, 2005 and changes during the nine months ended September 30, 2006 were as follows:

	Employee Stock Options	Non-employee Stock Options

	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at December 31, 2005	19,806,454	$ 38.82	601,870	$ 35.66
Granted	2,895,572	76.15	60,559	76.29
Exercised	(3,186,219)	35.25	(106,516)	31.69
Forfeited	(341,510)	59.68	(23,009)	33.87
Expired	(46,400)	30.55	(5,715)	28.46
Outstanding at September 30, 2006	19,127,897	$ 44.71	527,189	$ 41.29
Vested and expected to vest at September 30, 2006	18,071,104	$ 43.44	486,930	$ 39.40
Exercisable at September 30, 2006	12,501,480	$ 35.49	312,320	$ 29.16

The weighted average grant date fair value of employee stock options granted during the three months ended September 30, 2006 and 2005 was $18.06 and $15.28, respectively. The weighted average grant date fair value of employee stock options granted during the nine months ended September 30, 2006 and 2005 was $17.84 and 12.93, respectively.

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The total intrinsic value (*i.e.,* market price of the stock less the option exercise price) of employee stock options exercised during the three months ended September 30, 2006 and 2005 was $40 million and $34 million, respectively. The total intrinsic value of employee stock options exercised during the nine months ended September 30, 2006 and 2005 was $128 million and $110 million, respectively.

There were no non-employee stock options granted during both the three months ended September 30, 2006 and the three months ended September 30, 2005. The weighted average balance sheet date fair value for non-employee stock options granted during the nine months ended September 30, 2006 and 2005 was $16.94 and $19.39, respectively.

The total intrinsic value of non-employee options exercised during both the three months ended September 30, 2006 and the three months ended September 30, 2005 was $1 million. The total intrinsic value of non-employee options exercised during the nine months ended September 30, 2006 and 2005 was $5 million and $6 million, respectively.

The weighted average remaining contractual term and the aggregate intrinsic value of stock options outstanding and exercisable as of September 30, 2006 is as follows:

	September 30, 2006			
	Employee Stock Options		Non-employee Stock Options	
	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
	(in years)	(in millions)	(in years)	(in millions)
Outstanding	7.14	$ 603	6.77	$ 18
Vested and expected to vest	7.04	$ 593	6.61	$ 18
Exercisable	6.39	$ 510	5.67	$ 15

Restricted Stock Shares, Restricted Stock Units, and Performance Share Awards

A restricted stock share represents a grant of Common Stock to employee and non-employee participants that is subject to certain transfer restrictions and forfeiture provisions for a specified period of time. A restricted stock unit is an unfunded, unsecured right to receive a share of Common Stock at the end of a specified period of time, which is also subject to forfeiture and transfer restrictions. Generally, the restrictions on restricted stock shares and restricted stock units will lapse on the third anniversary of the date of grant. Restricted stock shares subject to the transfer restrictions and forfeiture provisions are considered nonvested shares and are not reflected as outstanding shares until the restrictions expire. Performance share awards are awards of units denominated in Common Stock. The number of units is determined over the performance period, and may be adjusted based on the satisfaction of certain performance goals. Performance share awards are payable in Common Stock.

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Employee restricted stock shares, restricted stock units and performance shares as of December 31, 2005 and changes during the nine months ended September 30, 2006 were as follows:

	Restricted Stock Shares	Weighted Average Grant Date Fair Value	Restricted Stock Units	Weighted Average Grant Date Fair Value	Performance Shares(1)	Weighted Average Grant Date Fair Value
Restricted at December 31, 2005	2,391,757	$ 39.03	1,213,644	$ 53.67	1,139,696	$ 46.63
Granted			1,597,269	76.30	322,764	76.15
Forfeited	(59,055)	44.94	(172,233)	69.52	(17,178)	52.59
Performance adjustment(2)					118,467	33.61
Released	(1,387,881)	34.86	(135,182)	36.24	(355,400)	33.61
Restricted at September 30, 2006	944,821	$ 44.92	2,503,498	$ 67.95	1,208,349	$ 56.99

(1) Performance shares reflect the target awarded, reduced for cancellations and vesting to date. The actual number of shares to be awarded at the end of each performance period will range between 50% and 150% of this target based upon a measure of the reported performance for the Company s Financial Services Businesses relative to stated goals.

(2) Represents additional shares issued based upon the attainment of performance goals for the Company s Financial Services Businesses.

The fair value of employee share awards released for the three months ended September 30, 2006 and 2005 was $4 million and $1 million, respectively. The fair value of employee share awards released for the nine months ended September 30, 2006 and 2005 was $142 million and $8 million, respectively.

Non-employee restricted stock shares and restricted stock units as of December 31, 2005 and changes during the nine months ended September 30, 2006 were as follows:

	Restricted Stock Shares	Weighted Average Balance Sheet Date Fair Value	Restricted Stock Units	Weighted Average Balance Sheet Date Fair Value
Restricted at December 31, 2005	21,019	$ 73.19	12,504	$ 73.19
Granted			128,267	76.40
Forfeited	(397)	38.69	(14,352)	73.58
Released	(11,668)	33.66	(820)	72.50

Restricted at September 30, 2006	8,954	$	76.25	125,599	$	76.25

The fair value of non-employee share awards released for the three months ended September 30, 2006 was de minimis. There were no non-employee awards released during the three months ended September 30, 2005. The fair value of non-employee share awards released for the nine months ended September 30, 2006 was $1 million. There were no non-employee awards released during the nine months ended September 30, 2005.

Unrecognized Compensation Cost

Unrecognized compensation cost for employee stock options as of September 30, 2006 was $51 million with a weighted average recognition period of 1.71 years. Unrecognized compensation cost for employee restricted stock awards, restricted stock units, and performance share awards as of September 30, 2006 was $138 million with a weighted average recognition period of 1.78 years.

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Notes to Unaudited Interim Consolidated Financial Statements (Continued)

Unrecognized compensation cost for non-employee stock options as of September 30, 2006 was $2 million with a weighted average recognition period of 1.30 years. Unrecognized compensation cost for non-employee restricted stock awards and restricted stock units as of September 30, 2006 was $7 million with a weighted average recognition period of 2.32 years.

Cash Received Upon Exercise of Stock Options and Tax Benefits Realized

Cash received for the exercise of 1,046,675 shares of employee and non-employee stock options for the three months ended September 30, 2006 was $37 million. Cash received for the exercise of 3,292,735 shares of employee and non-employee stock options for the nine months ended September 30, 2006 was $116 million.

The tax benefit realized for exercises of employee and non-employee stock options during the three months ended September 30, 2006 was $11 million. The tax benefit realized for exercises of employee and non-employee stock options during the nine months ended September 30, 2006 was $34 million.

The tax benefit realized upon vesting of restricted stock shares, restricted stock units, and performance shares for the three months ended September 30, 2006 was $1 million. The tax benefit realized upon vesting of restricted stock shares, restricted stock units, and performance shares for the nine months ended September 30, 2006 was $41 million.

8. EMPLOYEE BENEFIT PLANS

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

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

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

	Three Months Ended September 30,			
	Pension Benefits		Other Postretirement Benefits	
	2006	2005	2006	2005
	(in millions)			
Components of net periodic (benefit) cost				
Service cost	$ 40	$ 41	$ 3	$ 3
Interest cost	104	104	32	36
Expected return on plan assets	(185)	(199)	(22)	(20)
Amortization of prior service cost	6	6	(2)	(1)
Amortization of actuarial (gain) loss, net	12	6	4	9
Special termination benefits	1	1		
Net periodic (benefit) cost	$ (22)	$ (41)	$ 15	$ 27

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Notes to Unaudited Interim Consolidated Financial Statements (Continued)

	Nine Months Ended September 30,			
	Pension Benefits		Other Postretirement Benefits	
	2006	2005	2006	2005
	(in millions)			
Components of net periodic (benefit) cost				
Service cost	$ 120	$ 123	$ 9	$ 9
Interest cost	312	312	96	108
Expected return on plan assets	(555)	(597)	(66)	(60)
Amortization of prior service cost	18	18	(6)	(3)
Amortization of actuarial (gain) loss, net	36	18	13	27
Special termination benefits	4	8		
Net periodic (benefit) cost	$ (65)	$ (118)	$ 46	$ 81

9. SEGMENT INFORMATION

Segments

The Company has organized its principal operations into the Financial Services Businesses and the Closed Block Business. Within the Financial Services Businesses, the Company operates through three divisions, which together encompass 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 businesses to be divested are included in Corporate and Other operations within 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 or net income as determined in accordance with U.S. GAAP but is the measure of segment profit or loss used by the Company to evaluate segment performance and allocate resources, and, consistent with SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, is the measure of segment performance presented below.

Adjusted operating income is calculated by adjusting each segment s income from continuing operations before income taxes to exclude the following items, which are described in greater detail below:

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

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

- 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.

The excluded 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.

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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

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

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

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

Adjusted operating income of the International Insurance segment and International Investments segment, excluding the global derivatives business, 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

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Notes to Unaudited Interim Consolidated Financial Statements (Continued)

Company s Corporate and Other operations execute forward currency contracts with third parties to sell the hedged currency in exchange for U.S. dollars at a specified exchange rate. The maturities of these contracts correspond with the future periods in which the non-U.S. earnings are expected to be generated. These contracts do not qualify for hedge accounting under U.S. GAAP and, as noted above, all resulting profits or losses from such contracts are included in Realized investment gains (losses), net. When the contracts are terminated in the same period that the expected earnings emerge, the resulting positive or negative cash flow effect is included in

adjusted operating income (gains of $12 million and losses of $8 million for the three months ended September 30, 2006 and 2005, respectively, and gains of $26 million and losses of $64 million for the nine months ended September 30, 2006 and 2005, respectively). As of September 30, 2006 and December 31, 2005, the fair value of open contracts used for this purpose was a net asset of $98 million and a net asset of $110 million, respectively.

The Company uses interest and currency swaps and other derivatives to manage interest and currency exchange rate exposures arising from mismatches between assets and liabilities, including duration mismatches. For the derivative contracts that do not qualify for hedge accounting treatment, mark-to-market adjustments of open contracts as well as periodic settlements are included in Realized investment gains (losses), net. However, the periodic swap settlements, as well as other derivative related yield adjustments, are included in adjusted operating income to reflect the after-hedge yield of the underlying instruments. Adjusted operating income includes gains of $17 million and gains of $12 million for the three months ended September 30, 2006 and 2005, respectively, and gains of $37 million and gains of $48 million for the nine months ended September 30, 2006 and 2005, respectively, due to periodic settlements and yield adjustments of such contracts.

Certain products the Company sells are accounted for as freestanding derivatives or contain embedded derivatives. Changes in the fair value of these derivatives, along with any fees received or payments made relating to the derivative, are recorded in Realized investment gains (losses), net. These Realized investment gains (losses), net are included in adjusted operating income in the period in which the gain or loss is recorded. In addition, the changes in fair value of any associated derivative portfolio that is part of an economic hedging program related to the risk of these products (but which do not qualify for hedge accounting treatment under U.S. GAAP) are also included in adjusted operating income in the period in which the gains or losses on the derivative portfolio are recorded. Adjusted operating income includes gains of $14 million and gains of $6 million for the three months ended September 30, 2006 and 2005, respectively, and gains of $4 million and gains of $3 million for the nine months ended September 30, 2006 and 2005, respectively, related to these products and any associated derivative portfolio.

The Company invests in fixed maturities that, in addition to a stated coupon, provide a return based upon the results of an underlying portfolio of fixed income investments and related investment activity. The Company accounts for these investments as available for sale fixed maturities containing embedded derivatives that are marked-to-market through Realized investment gains (losses), net, based upon the change in value of the underlying portfolio. Adjusted operating income includes a portion of the cumulative realized investment gains on these embedded derivatives on an amortizing basis over the remaining life of the securities. However, adjusted operating income includes any cumulative realized investment losses immediately. Adjusted operating income includes gains of $1 million and no net gain or loss for the three months ended September 30, 2006 and 2005, respectively, and losses of $8 million and losses of $13 million for the nine months ended September 30, 2006 and 2005, respectively, related to these embedded derivatives.

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

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

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Notes to Unaudited Interim Consolidated Financial Statements (Continued)

these loans, including related derivative results and retained mortgage servicing rights, are a principal source of earnings for this business and are included in adjusted operating income. Also within the Company s Asset Management segment, its proprietary investing business makes investments for sale or syndication to other investors or for placement or co-investment in the Company s managed funds and structured products. The Realized investment gains (losses), net associated with the sale of these proprietary investments are a principal

source of earnings for this business and are included in adjusted operating income. In addition, Realized investment gains (losses), net from derivatives used to hedge certain foreign currency-denominated proprietary investments are included in adjusted operating income. Net realized investment gains of $3 million and $38 million related to these businesses were included in adjusted operating income for the three months ended September 30, 2006 and 2005, respectively. Net realized investment gains of $75 million and $92 million related to these businesses were included in adjusted operating income for the nine months ended September 30, 2006 and 2005, respectively.

The Company s Japanese insurance operations invest in dual currency fixed maturities and loans, which pay interest in U.S. dollars, while the principal is payable in Japanese yen. For fixed maturities that are categorized as held to maturity, and loans where the Company s intent is to hold them to maturity, the change in value related to foreign currency fluctuations associated with the U.S. dollar interest payments is recorded in Asset management fees and other income. Since these investments will be held until maturity, the foreign exchange impact will ultimately be realized as net investment income as earned and therefore the impact of currency fluctuations is excluded from current period adjusted operating income. This change in value related to foreign currency fluctuations recorded within Asset management fees and other income is excluded from adjusted operating income as an adjustment to Realized investment gains (losses), net, and was an increase of $18 million and an increase of $5 million for the three months ended September 30, 2006 and 2005, respectively, and was a decrease of $4 million and an increase of $8 million for the nine months ended September 30, 2006 and 2005, respectively.

The Company s international insurance operations offer certain insurance products that are denominated in U.S. dollars. The change in value of the available for sale U.S. dollar denominated investments that support these products due to changes in foreign currency exchange rates is recorded in Other comprehensive income, and thereby excluded from adjusted operating income. The related change in value due to changes in foreign currency exchange rates of the U.S. dollar denominated policyholder liabilities and deferred acquisitions costs associated with these products is recorded in Asset management fees and other income, and excluded from adjusted operating income as an adjustment to Realized investment gains (losses), net, which was an increase of $4 million for the three and nine months ended September 30, 2006 and a decrease of $1 million for the three and nine months ended September 30, 2005.

As part of the acquisition of CIGNA s retirement business, the Company entered into reinsurance agreements with CIGNA, including a modified-coinsurance-with-assumption arrangement that applied to the defined benefit guaranteed-cost contracts acquired. The net results of these contracts were recorded in Asset management fees and other income, as a result of the reinsurance arrangement, and such net results included realized investment gains and losses. These realized investment gains and losses were excluded from adjusted operating income as an adjustment to Realized investment gains (losses), net. There were no adjustments for the three and nine months ended September 30, 2006 or the three months ended September 30, 2005. Net realized investment gains of $13 million were excluded for the nine months ended September 30, 2005.

Investment gains and losses on trading account assets supporting insurance liabilities and changes in experience-rated contractholder liabilities due to asset value changes. Certain products included in the retirement business acquired from CIGNA, as well as certain products included in the International Insurance segment, are experience-rated in that investment results associated with these products will ultimately accrue to

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Notes to Unaudited Interim Consolidated Financial Statements (Continued)

contractholders. The investments supporting these experience-rated products, excluding mortgage loans, are classified as trading. These trading investments are reflected on the statements of financial position as Trading account assets supporting insurance liabilities, at fair value. Realized and unrealized gains and losses for these investments are reported in Asset management fees and other income. Investment income for these investments is reported in Net investment income. Mortgage loans that support these experience-rated products are carried at unpaid principal, net of unamortized discounts and an allowance for losses, and are reflected on the statements of financial position as Commercial loans.

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

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

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Notes to Unaudited Interim Consolidated Financial Statements (Continued)

The summary below reconciles adjusted operating income to income from continuing operations before income taxes:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	**2005**	**2006**	**2005**
		(in millions)		
Adjusted Operating Income before income taxes for Financial Services Businesses by Segment:				
Individual Life and Annuities	$ 375	$ 281	$ 844	$ 718
Group Insurance	90	60	166	144
Total Insurance Division	465	341	1,010	862
Asset Management	100	116	406	355
Financial Advisory	43	31	14	(51)
Retirement	109	110	388	407
Total Investment Division	252	257	808	711
International Insurance	397	358	1,059	970
International Investments	31	25	109	69
Total International Insurance and Investments Division	428	383	1,168	1,039
Corporate Operations	(21)	7	3	41
Real Estate and Relocation Services	36	43	75	85
Total Corporate and Other	15	50	78	126
Adjusted Operating Income before income taxes for Financial Services Businesses	1,160	1,031	3,064	2,738
Items excluded from Adjusted Operating Income:				
Realized investment gains (losses), net, and related adjustments	214	89	(70)	667
Charges related to realized investment gains (losses), net	7	(10)	30	(104)
Investment gains (losses) on trading account assets supporting insurance liabilities, net	257	(99)	(8)	(41)
Change in experience-rated contractholder liabilities due to asset value changes	(168)	47	28	(10)
Divested businesses	4	(1)	13	(5)
Income from continuing operations before income taxes for Financial Services Businesses	1,474	1,057	3,057	3,245
Income from continuing operations before income taxes for Closed Block Business	74	61	196	504

Income from continuing operations before income taxes	$ 1,548	$ 1,118	$ 3,253	$ 3,749

The Insurance division results reflect deferred policy acquisition costs as if the individual annuity business and group insurance business were stand-alone operations. The elimination of intersegment costs capitalized in accordance with this policy is included in consolidating adjustments within Corporate and Other operations.

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Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
	(in millions)			
Financial Services Businesses:				
Individual Life and Annuities	$ 1,050	$ 1,043	$ 3,116	$ 2,967
Group Insurance	1,155	1,038	3,381	3,150
Total Insurance Division	2,205	2,081	6,497	6,117
Asset Management	443	441	1,414	1,260
Financial Advisory	126	122	432	329
Retirement	1,112	1,047	3,215	3,002
Total Investment Division	1,681	1,610	5,061	4,591
International Insurance	1,924	1,954	5,807	5,782
International Investments	132	122	428	356
Total International Insurance and Investments Division	2,056	2,076	6,235	6,138
Corporate Operations	72	66	229	136
Real Estate and Relocation Services	93	100	246	256
Total Corporate and Other	165	166	475	392
Total	6,107	5,933	18,268	17,238
Items excluded from Adjusted Operating Income:				
Realized investment gains (losses), net, and related adjustments	214	89	(70)	667
Charges related to realized investment gains (losses), net		(6)	9	(9)
Investment gains (losses) on trading account assets supporting insurance liabilities, net	257	(99)	(8)	(41)
Divested businesses	9	9	35	27
Total Financial Services Businesses	6,587	5,926	18,234	17,882
Closed Block Business	1,889	1,865	5,589	5,963

Total per Unaudited Interim Consolidated Financial Statements	$ 8,476	$ 7,791	$ 23,823	$ 23,845

The Asset Management segment revenues include intersegment revenues of $82 million and $89 million for the three months ended September 30, 2006 and 2005, respectively, and $258 million and $269 million for the nine months ended September 30, 2006 and 2005, respectively, primarily consisting of asset-based management and administration fees. Management has determined the intersegment revenues with reference to market rates. Intersegment revenues are eliminated in consolidation in Corporate and Other.

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Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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

	September 30, 2006	December 31, 2005
	(in millions)	
Individual Life and Annuities	$ 97,142	$ 89,313
Group Insurance	34,730	27,466
Total Insurance Division	131,872	116,779
Asset Management	37,299	29,600
Financial Advisory	1,442	1,929
Retirement	122,427	119,259
Total Investment Division	161,168	150,788
International Insurance	57,329	54,186
International Investments	6,424	4,915
Total International Insurance and Investments Division	63,753	59,101
Corporate Operations	15,196	17,570
Real Estate and Relocation Services	1,397	1,053
Total Corporate and Other	16,593	18,623
Total Financial Services Businesses	373,386	345,291
Closed Block Business	73,515	72,485
Total per Unaudited Interim Consolidated Financial Statements	$ 446,901	$ 417,776

10. CONTINGENT LIABILITIES AND LITIGATION AND REGULATORY MATTERS

Contingent Liabilities

On an ongoing basis, the Company s internal supervisory and control functions review the quality of sales, marketing and other customer interface procedures and practices and may recommend modifications or enhancements. From time to time, this review process results in the discovery of 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 our businesses and operations that are specific to the Company and proceedings that are typical of the businesses in which the Company operates, including in both cases businesses that have either been divested or placed in wind-down status. Some of these

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Notes to Unaudited Interim Consolidated Financial Statements (Continued)

proceedings have been brought on behalf of various alleged classes of complainants. In certain of these matters, the plaintiffs are seeking large and/or indeterminate amounts, including punitive or exemplary damages.

Insurance and Annuities

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

The Company, along with a number of other insurance companies, received formal requests for information from the State of New York Attorney General s Office (NYAG), the Securities and Exchange Commission (SEC), the Connecticut Attorney General s Office, the Massachusetts Office of the Attorney General, the Department of Labor, the United States Attorney for the Southern District of California, the District Attorney of the County of San Diego, and various state insurance departments relating to payments to insurance intermediaries and certain other practices that may be viewed as anti-competitive. The Company may receive additional requests from these and other regulators and governmental authorities concerning these and related subjects. The Company is cooperating with these inquiries and has had discussions with certain authorities, including the NYAG, in an effort to resolve the inquiries into this matter. These matters are also the subject of litigation brought by private plaintiffs, including purported class actions that have been consolidated in the multidistrict litigation in the United States District Court for the District of New Jersey, *In re Employee Benefit Insurance Brokerage Antitrust Litigation*, and two shareholder derivative actions, *Gillespie v. Ryan* and *Kahn v. Agnew,* and the California Department of Banking and Insurance. Both derivative actions were dismissed without prejudice. In *Gillespie*, the plaintiff entered into a tolling agreement with the Company to permit a Special Evaluation Committee of the Board of Directors to investigate and evaluate his demand that the Company take action regarding these matters. The Committee has completed its investigation and has informed counsel for Mr. Gillespie that it has determined to refuse his demand.

In April 2005, the Company voluntarily commenced a review of the accounting for its reinsurance arrangements to confirm that it complied with applicable accounting rules. This review included an inventory and examination of current and past arrangements, including those relating to the Company s wind down and divested businesses and discontinued operations. Subsequent to commencing this voluntary review, the Company received a formal request from the Connecticut Attorney General for information regarding its participation in reinsurance transactions generally and a formal request from the SEC for information regarding certain reinsurance contracts entered into with a single counterparty since 1997 as well as specific contracts entered into with that counterparty in the years 1997 through 2002 relating to the Company s property and casualty insurance

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Notes to Unaudited Interim Consolidated Financial Statements (Continued)

operations that were sold in 2003. The Company accounts for these property and casualty contracts as reinsurance. However, if as a result of these examinations deposit accounting rather than reinsurance accounting were required to be applied to these property and casualty contracts, there would be no impact on the consolidated financial statements of the Company for any interim or annual period subsequent to December 31, 2002 and consolidated net income (loss) from continuing operations before extraordinary gain on acquisition and cumulative effect of accounting change would be decreased by approximately $25 million in 2002 and $49 million in 2001. These examinations are ongoing and not yet complete and it is possible that the Company may receive additional requests from regulators relating to reinsurance arrangements. The Company intends to cooperate with all such requests.

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

Securities

In 1999, a class action lawsuit, *Burns, et al. v. Prudential Securities, Inc., et al.*, was filed in the Marion County, Ohio Court of Common Pleas against Jeffrey Pickett (a former Prudential Securities Financial Advisor) and Prudential Securities alleging that Pickett transferred, without authorization, his clients equity mutual funds into fixed income mutual funds in October 1998. The claims were based on theories of conversion, breach of contract, breach of fiduciary duty and negligent supervision. In October 2002, the case was tried and the jury returned a verdict against Prudential Securities and Pickett for $11.7 million in compensatory damages and against Prudential Securities for $250 million in punitive damages. In July 2003, the court denied Prudential Securities motion to set aside or reduce the jury verdict and sustained the judgment in the amount of $269 million, including prejudgment interest and attorneys fees. In July 2006, the Court of Appeals, Third Appellate District, affirmed the award of $11.7 million in compensatory damages against Prudential Securities and Pickett and reduced the award of punitive damages against Prudential Securities from $250 million to $6.8 million and affirmed the award for pre- and post-judgment interest and attorneys fees. In August 2006, the Court of Common Pleas entered final judgment in the amount of $32 million and Prudential Securities satisfied the judgment.

Prudential Securities has been named as a defendant in a number of industry-wide purported class actions in the United States District Court for the Southern District of New York relating to its former securities underwriting business. Plaintiffs in one consolidated proceeding, captioned *In re: Initial Public Offering Securities Litigation*, allege, among other things, that the underwriters engaged in a scheme involving tying agreements, undisclosed compensation arrangements and research analyst conflicts to manipulate and inflate the prices of shares sold in initial public offerings in violation of the federal securities laws. Certain issuers of these securities and their current and former officers and directors have also been named as defendants. In October 2004, the district court granted plaintiffs motion for class certification in six focus cases. The underwriter defendants appealed that ruling to the United States Court of Appeals for the Second Circuit, which heard argument in March 2006. In June 2004, plaintiffs entered into a settlement agreement with the issuers, officers and directors named as defendants in the lawsuits, which the district court preliminarily approved in February

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

2005. In August 2000, Prudential Securities was named as a defendant, along with other underwriters, in a purported class action, captioned *CHS Electronics Inc. v. Credit Suisse First Boston Corp. et al*., which alleges on behalf of issuers of securities in initial public offerings that the defendants conspired to fix at 7% the discount that underwriting syndicates receive from issuers in violation of federal antitrust laws. Plaintiffs moved for class certification in September 2004 and for partial summary judgment in November 2005. The summary judgment motion has been deferred pending disposition of the class certification motion. In April 2006, the court denied class certification. In August 2006, the United States Court of Appeals for the Second Circuit granted plaintiffs petition for review of that decision. In a related action, captioned *Gillet v. Goldman Sachs et al.*, plaintiffs allege substantially the same antitrust claims on behalf of investors, though only injunctive relief is currently being sought.

Other Matters

Mutual Fund Market Timing Practices

In August 2006, Prudential Equity Group, LLC (PEG), a wholly owned subsidiary of the Company, reached a global resolution of the previously disclosed regulatory and criminal investigations into deceptive market timing related activities involving PEG s former Prudential Securities operations. This resolution takes the form of separate settlements between PEG and each of the United States Attorney for the District of Massachusetts (USAO), the Secretary of the Commonwealth of Massachusetts, Securities Division (MSD), the Securities and Exchange Commission (SEC), the National Association of Securities Dealers (NASD), the New York Stock Exchange (NYSE), the New Jersey Bureau of Securities (NJBS) and the New York Attorney General s Office (NYAG).

The investigations of the above named authorities have focused on 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 settlements relate to conduct that generally occurred between 1999 and September 2003. 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.

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 has paid $270 million into a Fair Fund administered by the SEC to compensate those harmed by the market timing activities. In addition, $330 million has been paid in fines and penalties. In the settlements, PEG has agreed to retain, at PEG s ongoing cost and expense, the services of an Independent Distribution Consultant acceptable to certain of the authorities to develop a proposed distribution plan for the distribution of Fair Fund amounts according to a methodology developed in consultation with and acceptable to certain of the authorities. In addition, as part of these settlements PEG has agreed, among other things, to continue to cooperate with the above named authorities in any litigation, ongoing investigations or other proceedings relating to or arising from their investigations into these matters.

In connection with the settlements, the Company has agreed with the USAO, among other things, to cooperate with the USAO and to maintain and periodically report on the effectiveness of its compliance procedures.

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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 2003, in connection with the investigations, the SEC filed a civil action against individual Prudential Securities brokers and a branch manager; the MSD filed administrative complaints against both Prudential Securities and certain brokers and branch managers. The MSD administrative complaint against Prudential Securities has been settled. Two former Prudential Securities brokers and a branch manager have pled guilty to criminal charges brought by the USAO based on their participation in deceptive practices relating to market timing activities, and it is possible that additional civil and/or criminal charges may be brought against these and other former Prudential Securities personnel.

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

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

Other

In November 2003, an action was commenced in the United States Bankruptcy Court for the Southern District of New York, *Enron Corp. v. J.P. Morgan Securities, Inc., et al.*, against approximately 100 defendants, including Prudential Insurance and related entities, which invested in Enron s commercial paper. The complaint alleges that Enron s October 2001 prepayment of its commercial paper is a voidable preference under the bankruptcy laws and constitutes a fraudulent conveyance and that the Company and related entities received prepayment of $125 million. A motion by all defendants to dismiss the complaint was denied in June 2005. Defendants motion for leave to appeal is pending.

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

In August 1999, a Prudential Insurance employee and several Prudential Insurance retirees filed an action in the United States District Court for the Southern District of Florida, *Dupree, et al., v. Prudential Insurance, et al.*, against Prudential Insurance and its Board of Directors in connection with a group annuity contract entered into in 1989 between the Prudential Retirement Plan and Prudential Insurance. The suit alleged that the annuitization of certain retirement benefits violated ERISA and that, in the event of demutualization, Prudential Insurance would retain shares distributed under the annuity contract in violation of ERISA s fiduciary duty requirements. In July 2001, plaintiffs filed an amended complaint dropping three counts, and the Company filed an answer denying the essential allegations of the complaint. The amended complaint seeks injunctive and monetary relief, including the return of what are claimed to be excess investment and advisory fees paid by the Retirement Plan to Prudential. In March 2002, the court dismissed certain of the claims against the individual defendants. A non-jury trial was concluded in January 2005. The court has not yet issued its decision.

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

Discontinued Operations

In November 1996, plaintiffs filed a purported class action lawsuit against Prudential Insurance, the Prudential Home Mortgage Company, Inc. and several other subsidiaries in the Superior Court of New Jersey, Essex County, *Capitol Life Insurance Company v. Prudential Insurance, et al.*, in connection with the sale of certain subordinated mortgage securities sold by a subsidiary of Prudential Home Mortgage. In February 1999, the court entered an order dismissing all counts without prejudice with leave to refile after limited discovery. In May 2000, plaintiffs filed a second amended complaint that alleges violations of the New Jersey securities and RICO statutes, fraud, conspiracy and negligent misrepresentation, and seeks compensatory as well as treble and

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

punitive damages. Defendants filed a motion to dismiss that was denied in October 2001. In October 2002, plaintiffs motion for class certification was denied. Since that time, the court has permitted nine additional investors to intervene as plaintiffs. In August 2005, the court dismissed the New Jersey Securities Act and RICO claims and the negligent misrepresentation claim. Plaintiffs application for interlocutory appeal of this ruling was denied. In August 2006, the court denied Prudential s motion for summary judgment. A trial date has not yet been set.

In 2000, a nationwide class action, *Shane v. Humana, et al.*, was brought on behalf of provider physicians and physician groups in the United States District Court for the Southern District of Florida. The complaint alleges that Prudential Insurance and other health care companies engaged in an industry-wide conspiracy to defraud physicians by failing to pay under provider agreements and by unlawfully coercing providers to enter into agreements with unfair and unreasonable terms. An amended complaint, naming additional plaintiffs, including three state medical associations, and an additional defendant, was filed in March 2001, and alleges claims of breach of contract, quantum meruit, unjust enrichment, violations of the Racketeer Influenced and Corrupt Organizations Act, or RICO, conspiracy to violate RICO, aiding and abetting RICO violations, and violations of state prompt pay statutes and the California unfair business practices statute. The amended complaint sought compensatory and punitive damages in unspecified amounts, treble damages pursuant to RICO, and attorneys fees. In September 2002, the district court granted plaintiffs motion for class certification of a nationwide class of provider physicians which was affirmed in September 2004 by the United States Court of Appeals for the Eleventh Circuit with respect only to the federal claims for conspiracy to violate RICO and aiding and abetting RICO violations. In September 2005, the district court entered a final order approving the settlement of these claims by Prudential Insurance, which provides for payment to plaintiffs in the amount of $22 million. Two members of the plaintiff class appealed the final order. In February 2006, the appeals were dismissed. One appeal was reinstated in April 2006 and dismissed in June 2006. The matter has settled.

Summary

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

PRUDENTIAL FINANCIAL, INC.

Unaudited Interim Supplemental Combining Statements of Financial Position

September 30, 2006 and December 31, 2005 (in millions)

	September 30, 2006			December 31, 2005		
	Financial Services Businesses	Closed Block Business	Consolidated	Financial Services Businesses	Closed Block Business	Consolidated
ASSETS						
Fixed maturities:						
Available for sale, at fair value	$ 108,346	$ 49,731	$ 158,077	$ 105,188	$ 49,246	$ 154,434
Held to maturity, at amortized cost	3,473		3,473	3,249		3,249
Trading account assets supporting insurance liabilities, at fair value	14,453		14,453	13,781		13,781
Other trading account assets, at fair value	1,933		1,933	1,443		1,443
Equity securities, available for sale, at fair value	2,893	3,517	6,410	2,627	3,216	5,843
Commercial loans	18,139	7,243	25,382	17,177	7,264	24,441
Policy loans	3,350	5,407	8,757	2,967	5,403	8,370
Securities purchased under agreements to resell	187		187	413		413
Other long-term investments	4,827	934	5,761	4,495	973	5,468
Short-term investments	2,705	1,773	4,478	2,565	1,394	3,959
Total investments	160,306	68,605	228,911	153,905	67,496	221,401
Cash and cash equivalents	7,361	2,206	9,567	5,493	2,306	7,799
Accrued investment income	1,466	769	2,235	1,358	709	2,067
Reinsurance recoverables	1,908		1,908	3,548		3,548
Deferred policy acquisition costs	9,540	1,030	10,570	8,357	1,081	9,438
Other assets	17,442	905	18,347	15,069	893	15,962
Separate account assets	175,363		175,363	157,561		157,561
TOTAL ASSETS	$ 373,386	$ 73,515	$ 446,901	$ 345,291	$ 72,485	$ 417,776
LIABILITIES AND ATTRIBUTED EQUITY						
LIABILITIES						
Future policy benefits	$ 55,423	$ 50,449	$ 105,872	$ 51,926	$ 50,113	$ 102,039
Policyholders account balances	75,429	5,559	80,988	69,924	5,568	75,492
Policyholders dividends	547	3,344	3,891	696	3,717	4,413
Reinsurance payables	1,405		1,405	3,069		3,069
Securities sold under agreements to repurchase	6,256	5,790	12,046	6,801	5,716	12,517
Cash collateral for loaned securities	3,797	3,118	6,915	3,425	2,393	5,818
Income taxes payable	2,827	127	2,954	2,136	78	2,214
Securities sold but not yet purchased	313		313	223		223
Short-term debt	9,418	1,347	10,765	9,447	1,667	11,114
Long-term debt	7,464	1,750	9,214	6,520	1,750	8,270
Other liabilities	13,091	886	13,977	11,909	374	12,283
Separate account liabilities	175,363		175,363	157,561		157,561

Total liabilities	351,333	72,370	423,703	323,637	71,376	395,013
COMMITMENTS AND CONTINGENT LIABILITIES						
ATTRIBUTED EQUITY						
Accumulated other comprehensive income	821	73	894	1,108	126	1,234
Other attributed equity	21,232	1,072	22,304	20,546	983	21,529
Total attributed equity	22,053	1,145	23,198	21,654	1,109	22,763
TOTAL LIABILITIES AND ATTRIBUTED EQUITY	$ 373,386	$ 73,515	$ 446,901	$ 345,291	$ 72,485	$ 417,776

See Notes to Unaudited Interim Supplemental Combining Financial Information

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PRUDENTIAL FINANCIAL, INC.

Unaudited Interim Supplemental Combining Statements of Operations

For the three months ended September 30, 2006 and 2005 (in millions)

	Three Months Ended September 30,					
	2006			2005		
	Financial Services Businesses	Closed Block Business	Consolidated	Financial Services Businesses	Closed Block Business	Consolidated
REVENUES						
Premiums	$ 2,550	$ 814	$ 3,364	$ 2,577	$ 822	$ 3,399
Policy charges and fee income	583		583	662		662
Net investment income	1,957	914	2,871	1,734	931	2,665
Realized investment gains (losses), net	239	150	389	133	97	230
Asset management fees and other income	1,258	11	1,269	820	15	835
Total revenues	6,587	1,889	8,476	5,926	1,865	7,791
BENEFITS AND EXPENSES						
Policyholders benefits	2,622	894	3,516	2,469	912	3,381
Interest credited to policyholders account balances	884	34	918	607	35	642
Dividends to policyholders	32	697	729	29	666	695
General and administrative expenses	1,575	190	1,765	1,764	191	1,955
Total benefits and expenses	5,113	1,815	6,928	4,869	1,804	6,673
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	1,474	74	1,548	1,057	61	1,118
Income tax expense (benefit)	390	21	411	(280)	19	(261)
INCOME FROM CONTINUING OPERATIONS	1,084	53	1,137	1,337	42	1,379
Income (loss) from discontinued operations, net of taxes	68		68	(15)		(15)
NET INCOME	$ 1,152	$ 53	$ 1,205	$ 1,322	$ 42	$ 1,364

See Notes to Unaudited Interim Supplemental Combining Financial Information

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PRUDENTIAL FINANCIAL, INC.

Unaudited Interim Supplemental Combining Statements of Operations

For the Nine Months ended September 30, 2006 and 2005 (in millions)

	Nine Months Ended September 30,					
	2006			2005		
	Financial Services Businesses	Closed Block Business	Consolidated	Financial Services Businesses	Closed Block Business	Consolidated
REVENUES						
Premiums	$ 7,714	$ 2,617	$ 10,331	$ 7,685	$ 2,631	$ 10,316
Policy charges and fee income	1,921		1,921	1,891		1,891
Net investment income	5,629	2,752	8,381	5,011	2,781	7,792
Realized investment gains (losses), net	64	182	246	713	510	1,223
Asset management fees and other income	2,906	38	2,944	2,582	41	2,623
Total revenues	18,234	5,589	23,823	17,882	5,963	23,845
BENEFITS AND EXPENSES						
Policyholders benefits	7,733	2,898	10,631	7,469	2,930	10,399
Interest credited to policyholders account balances	2,018	105	2,123	1,895	103	1,998
Dividends to policyholders	74	1,803	1,877	169	1,856	2,025
General and administrative expenses	5,352	587	5,939	5,104	570	5,674
Total benefits and expenses	15,177	5,393	20,570	14,637	5,459	20,096
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	3,057	196	3,253	3,245	504	3,749
Income tax expense	852	56	908	350	170	520
INCOME FROM CONTINUING OPERATIONS	2,205	140	2,345	2,895	334	3,229
Income (loss) from discontinued operations, net of taxes	46		46	(53)		(53)
NET INCOME	$ 2,251	$ 140	$ 2,391	$ 2,842	$ 334	$ 3,176

See Notes to Unaudited Interim Supplemental Combining Financial Information

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Supplemental Combining Financial Information

1. BASIS OF PRESENTATION

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

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

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

2. ALLOCATION OF RESULTS

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

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

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

Income taxes are allocated between the Financial Services Businesses and the Closed Block Business as if they were separate companies based on the taxable income or losses and other tax characterizations of each

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Supplemental Combining Financial Information (Continued)

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

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

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

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

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

Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) addresses the consolidated financial condition of Prudential Financial as of September 30, 2006, compared with December 31, 2005, and its consolidated results of operations for the three months and nine months ended September 30, 2006 and September 30, 2005. You should read the following analysis of our consolidated financial condition and results of operations in conjunction with the MD&A, the Risk Factors section and the audited Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005, 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 Insurance division consists of our Individual Life and Annuities and Group Insurance segments. The Investment division consists of our Asset Management, Financial Advisory, and Retirement segments. The International Insurance and Investments division consists of our International Insurance and International Investments segments. Our Corporate and Other operations include our real estate and relocation services business, as well as corporate items and initiatives that are not allocated to business segments. Corporate and Other operations also include businesses that have been or will be divested and businesses that we have placed in wind-down status.

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

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

Closed Block Business

In connection with the demutualization, we ceased offering domestic participating products. The liabilities for our traditional domestic in force participating products were segregated, together with assets, in a regulatory mechanism referred to as the Closed Block. The Closed Block is designed generally to provide for the reasonable expectations for future policy dividends after demutualization of holders of participating individual life insurance policies and annuities included in the Closed Block by allocating assets that will be used exclusively for payment of benefits, including policyholder dividends, expenses and taxes with respect to these products. See Note 4 to the Unaudited Interim Consolidated Financial Statements for more information on the Closed Block. At the time of demutualization, we determined the amount of Closed Block assets so that the Closed Block assets initially had a lower book value than the Closed Block liabilities. We expect that the Closed Block assets will generate sufficient cash flow, together with anticipated revenues from the Closed Block policies, over the life of the Closed Block to fund payments of all expenses, taxes, and policyholder benefits to be paid to, and the reasonable dividend expectations of, holders of the Closed Block policies. We also segregated for accounting purposes the assets that we need to hold outside the Closed Block to meet capital requirements related to the Closed Block policies. No policies sold after demutualization will be added to the Closed Block, and its in force business is expected to ultimately decline as we pay policyholder benefits in full. We also expect the proportion of our business represented by the Closed Block to decline as we grow other businesses.

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

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

Executive Summary

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

Significant developments and events in the first nine months of 2006 reflect our continued efforts to redeploy capital effectively to seek enhanced returns. These developments included:

- The continuation of our share repurchase program. In the first nine months of 2006, we repurchased 24.7 million shares of Common Stock at a total cost of $1.9 billion and are authorized, under a stock repurchase program authorized by Prudential Financial s Board of Directors in November 2005, to repurchase up to an additional $0.6 billion of Common Stock during 2006.

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

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

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Shown below are the contributions of each segment and Corporate and Other operations to our adjusted operating income for the three and nine months ended September 30, 2006 and 2005 and a reconciliation of adjusted operating income of our segments and Corporate and Other operations to income from continuing operations before income taxes.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
	(in millions)			
Adjusted operating income before income taxes for segments of the Financial Services Businesses:				
Individual Life and Annuities	$ 375	$ 281	$ 844	$ 718
Group Insurance	90	60	166	144
Asset Management	100	116	406	355
Financial Advisory	43	31	14	(51)
Retirement	109	110	388	407
International Insurance	397	358	1,059	970
International Investments	31	25	109	69
Corporate and Other	15	50	78	126
Items excluded from adjusted operating income:				
Realized investment gains (losses), net, and related adjustments	214	89	(70)	667
Charges related to realized investment gains (losses), net	7	(10)	30	(104)
Investment gains (losses) on trading account assets supporting insurance liabilities, net	257	(99)	(8)	(41)
Change in experience-rated contractholder liabilities due to asset value changes	(168)	47	28	(10)
Divested businesses	4	(1)	13	(5)
Income from continuing operations before income taxes for Financial Services Businesses	1,474	1,057	3,057	3,245
Income from continuing operations before income taxes for Closed Block Business	74	61	196	504
Consolidated income from continuing operations before income taxes	$ 1,548	$ 1,118	$ 3,253	$ 3,749

Results for the three and nine months ended September 30, 2006 presented above reflect the following:

Individual Life and Annuities segment results for both the third quarter and first nine months of 2006 improved in comparison to the corresponding prior year periods. Individual life results benefited in the current year periods from a net reduction in amortization of deferred policy acquisition costs and other costs, reflecting updates and refinements of our actuarial assumptions based on an annual review, and from compensation received in the third quarter based on multi-year profitability of third-party products we distribute. Individual annuities results for the current year periods improved compared to the prior year periods due to higher fee income reflecting higher average asset balances as well as a contribution from the variable annuity business acquired from The Allstate Corporation on June 1, 2006. Individual annuities results for both the current and prior year periods benefited from reductions in amortization of deferred policy acquisition costs and other costs, reflecting increased estimates of profitability based on an annual review.

Group Insurance segment results for both the third quarter and first nine months of 2006 improved in comparison to the corresponding prior year periods, primarily due to more favorable group disability results, which reflected refinements in group disability reserves as a result of annual reviews in both periods as well as more favorable claims experience. Growth in our group life business and an increased

contribution from investment results also contributed to the improved results, but were partially offset by less favorable current year claims experience in our group life business in the first nine months of 2006.

Asset Management segment results for the third quarter of 2006 were lower than in the third quarter of 2005, primarily due to decreased income from our commercial mortgage operations, partially offset by higher asset management fees as a result of increased asset values due to market appreciation and net asset flows. Results for the first nine months of 2006 improved $51 million, primarily due to higher asset based fees as a result of increased asset values due to market appreciation and net asset flows, together with increased income from our proprietary investing operations, partially offset by increased performance-related compensation costs.

Financial Advisory segment results for both the third quarter and first nine months of 2006 improved in comparison to the corresponding prior year periods, reflecting increased income from our 38% share of the retail brokerage joint venture with Wachovia, partially offset by higher expenses in the first nine months of 2006 related to obligations and costs we retained in connection with the contributed businesses, primarily for litigation and regulatory matters.

Retirement segment results for the third quarter of 2006 were essentially unchanged from the third quarter of 2005, and results for the first nine months of 2006 declined from the first nine months of 2005. The effect of lower reserve releases due to updates of client census data in 2006, lower mortgage prepayment income in 2006, the collection of investment income on a previously defaulted bond in 2005, higher crediting rates on full service general account liabilities and expenses to expand our full service retirement capabilities more than offset growth of fee income due to higher full service retirement account balances, improved investment results from a larger base of invested assets in our institutional investment products business and lower transition costs in 2006.

International Insurance s adjusted operating income increased $39 million from the third quarter of 2005 primarily reflecting improved results from our Life Planner operations, consisting of our international insurance operations other than Gibraltar Life. Excluding the impact of currency fluctuations, the results of our Gibraltar Life operation were essentially unchanged from the third quarter of 2005 as improved investment income margins were offset by the effect of a current year increase in our estimated liability for guaranty fund assessments in comparison to a reduction of the liability in the prior year. On the same basis, the increase in adjusted operating income from our Life Planner operations reflects the continued growth of our Japanese and Korean Life Planner operations and improved investment income margins. Results for the first nine months of 2006 improved $89 million from the first nine months of 2005, including a $119 million increase from our Life Planner operations. Excluding the impact of currency fluctuations, the improved results of our Life Planner operations came primarily from continued growth of our Japanese and Korean Life Planner operations and improved investment margins. On the same basis, Gibraltar Life s current year results declined, reflecting less favorable mortality experience and expenses than those of the prior year, refinements for policy liabilities and reserves that reduced current year results and benefited prior year results, and the third quarter changes in our liability for guaranty fund assessments.

International Investments segment results improved in the third quarter of 2006 due to higher earnings in our global derivatives business. Results for the first nine months of 2006 also benefited from $16 million of income that represented market value changes on securities held relating to trading exchange memberships, as well as improved results from the segment s asset management operations.

Realized investment gains (losses), net, and related adjustments for the Financial Services Businesses amounted to gains of $214 million in the three months ended September 30, 2006, and losses of $70 million in the nine months ended September 30, 2006, respectively, reflecting in both periods gains on sales of other invested assets and equity securities, and fluctuations in the value of derivative instruments covering our foreign currency risk and investments offset by net losses on sales and impairments of fixed maturity securities.

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The Closed Block Business s income from continuing operations before income taxes increased $13 million from the prior year quarter, reflecting an increase in net realized investment gains, partially offset by an increase in dividends to policyholders, which includes an increase to the cumulative earnings policyholder dividend obligation. The increase in net realized investment gains reflects net gains in the value of derivative instruments used to manage the duration of our fixed maturity portfolio compared to net losses in the prior year quarter, partially offset by declines in net gains on sales and prepayments of fixed maturity securities and declines in net gains on sales of equity securities from the prior year quarter.

Accounting Policies & Pronouncements

Accounting Pronouncements Adopted

See Note 2 to the Unaudited Interim Consolidated Financial Statements for a discussion of recently adopted accounting pronouncements, including the standard on accounting for share-based payments, FASB Statement No. 123(R) (revised 2004), Share-Based Payment, which was implemented effective January 1, 2006.

Recent Accounting Pronouncements

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

Consolidated Results of Operations

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
	(in millions)			
Financial Services Businesses by segment:				
Individual Life and Annuities	$ 361	$ 295	$ 746	$ 749
Group Insurance	83	83	148	212
Total Insurance Division	444	378	894	961
Asset Management	95	117	401	356
Financial Advisory	43	31	14	(51)

Retirement	146	26	272	428
Total Investment Division	284	174	687	733
International Insurance	577	352	1,219	1,054
International Investments	31	27	110	69
Total International Insurance and Investments Division	608	379	1,329	1,123
Corporate and Other	138	126	147	428
Income from continuing operations before income taxes for Financial Services Businesses	1,474	1,057	3,057	3,245
Income from continuing operations before income taxes for Closed Block Business	74	61	196	504
Income from continuing operations before income taxes	1,548	1,118	3,253	3,749
Income tax expense (benefit)	411	(261)	908	520
Income from continuing operations	1,137	1,379	2,345	3,229
Income (loss) from discontinued operations, net of taxes	68	(15)	46	(53)
Net income	$ 1,205	$ 1,364	$ 2,391	$ 3,176

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In managing our business, we analyze operating performance separately for our Financial Services Businesses and our Closed Block Business. For the Financial Services Businesses, we analyze our segments operating performance using adjusted operating income. Results of the Closed Block Business for all periods are evaluated and presented only in accordance with U.S. GAAP. Adjusted operating income does not equate to income from continuing operations before income taxes or net income as determined in accordance with U.S. GAAP but is the measure of segment profit or loss we use to evaluate segment performance and allocate resources, and consistent with SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, is our measure of segment performance. Adjusted operating income is calculated for the segments of the Financial Services Businesses by adjusting each segment s income from continuing operations before income taxes to exclude the following items:

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

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

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

The excluded items are important to an understanding of our overall results of operations. Adjusted operating income is not a substitute for income determined in accordance with U.S. GAAP, and our definition of adjusted operating income may differ from that used by other companies. However, we believe that the presentation of adjusted operating income as we measure it for management purposes enhances understanding of our results of operations by highlighting the results from ongoing operations and the underlying profitability of the Financial Services Businesses. Adjusted operating income excludes Realized investment gains (losses), net, except as indicated below, and related charges and adjustments. A significant element of realized investment gains and losses are impairments and credit-related and interest rate-related gains and losses. Impairments and losses from sales of credit-impaired securities, the timing of which depends largely on market credit cycles, can vary considerably across periods. The timing of other sales that would result in gains or losses, such as interest rate-related gains or losses, is largely subject to our discretion and influenced by market opportunities, as well as our tax profile. Trends in the underlying profitability of our businesses can be more clearly identified without the fluctuating effects of these transactions. Similarly, adjusted operating income excludes investment gains and losses on trading account assets supporting insurance liabilities and changes in experience-rated contractholder liabilities due to asset value changes, because these recorded changes in asset and liability values will ultimately accrue to the contractholders. Adjusted operating income excludes the results of divested businesses because they are not relevant to understanding our ongoing operating results. The contributions to income/loss of wind-down businesses that we have not divested remain in adjusted operating income. See Note 9 to the Unaudited Interim Consolidated Financial Statements for further information on the presentation of segment results.

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

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Results of Operations for Financial Services Businesses by Segment

Insurance Division

Individual Life and Annuities

Operating Results

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
	(in millions)			
Operating results:				
Revenues:				
Individual Life	$ 467	$ 602	$ 1,611	$ 1,682
Individual Annuities	583	441	1,505	1,285
	1,050	1,043	3,116	2,967
Benefits and expenses:				
Individual Life	284	482	1,199	1,326
Individual Annuities	391	280	1,073	923
	675	762	2,272	2,249
Adjusted operating income:				
Individual Life	183	120	412	356
Individual Annuities	192	161	432	362
	375	281	844	718
Realized investment gains (losses), net, and related adjustments(1)	(29)	20	(128)	42
Related charges(1)(2)	15	(6)	30	(11)
Income from continuing operations before income taxes	$ 361	$ 295	$ 746	$ 749

(1)

Revenues exclude Realized investment gains (losses), net, and related charges and adjustments. The related charges represent payments related to the market value adjustment features of certain of our annuity products. See Realized Investment Gains and General Account Investments Realized Investment Gains.

(2) Benefits and expenses exclude related charges which represent the unfavorable (favorable) impact of Realized investment gains (losses), net, on change in reserves and the amortization of deferred policy acquisition costs and value of business acquired.

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

Adjusted Operating Income

2006 to 2005 Three Month Comparison. The segment s individual life business adjusted operating income increased $63 million, from $120 million in the third quarter of 2005 to $183 million in the third quarter of 2006.

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Adjusted operating income for the third quarter of 2006 includes a $46 million benefit from a net reduction in amortization of deferred policy acquisition costs and other costs. The net reduction in amortization and other costs is due to an increased estimate of total gross profits used as a basis for amortizing deferred policy acquisition costs and unearned revenue reserves, based on an annual review, primarily reflecting improved mortality and maintenance expenses, partially offset by refinements in other reserves. Third quarter 2006 results also improved $20 million from the prior year quarter, as the current year quarter includes a $25 million benefit and the prior year quarter included a $5 million benefit from compensation received based on multi-year profitability of third-party products we distribute. These benefits, together with a higher contribution from investment income, net of interest credited and interest expense, reflecting higher assets in the general account and improved yields in the third quarter of 2006, were partially offset by less favorable mortality experience, net of reinsurance, compared to the third quarter of 2005.

Adjusted operating income of the segment s individual annuity business increased $31 million, from $161 million in the third quarter of 2005 to $192 million in the third quarter of 2006. Adjusted operating income for the third quarter of 2006 includes a $37 million benefit from a reduction in amortization of deferred policy acquisition costs and other costs due to an increased estimate of total gross profits used as a basis for amortizing deferred policy acquisition costs, based on an annual review, primarily reflecting improved net interest spread from increased investment yields. Adjusted operating income for the third quarter of 2005 included a net $57 million benefit from a net reduction in amortization of deferred policy acquisition and other costs and a decrease in our reserve for the guaranteed minimum death benefit feature of our variable annuity product, due to an increased estimate of total gross profits used as a basis for amortizing deferred policy acquisition and other costs reflecting improved net interest spread from increased investment yields, decreased cost of actual and expected death claims and modeling refinements implemented, based on an annual review. Absent these factors, adjusted operating income of the segment s individual annuity business increased $51 million from the third quarter of 2005, including a $24 million contribution to third quarter 2006 results from the variable annuity business acquired from Allstate on June 1, 2006, as well as higher fee income driven by higher average asset balances due to market appreciation in our variable annuity account values. The contribution of the acquired Allstate business to third quarter 2006 adjusted operating income consists of revenues of $99 million and benefits and expenses of $75 million.

2006 to 2005 Nine Month Comparison. The segment s individual life business adjusted operating income increased $56 million, from $356 million in the first nine months of 2005 to $412 million in the first nine months of 2006. Adjusted operating income for the first nine months of 2006 includes a $46 million benefit from a net reduction in amortization of deferred policy acquisition costs and other costs, and the benefit from compensation received related to third-party products we distribute as discussed above. Results for the 2005 period benefited $10 million from the collection of investment income on a previously defaulted bond.

Adjusted operating income of the segment s individual annuity business increased $70 million, from $362 million in the first nine months of 2005 to $432 million in the first nine months of 2006. Adjusted operating income for the first nine months of 2006 includes a $37 million benefit from a reduction in amortization of deferred policy acquisition costs and other costs and adjusted operating income for the first nine months of 2005 included a net $57 million benefit from a net reduction in amortization of deferred policy acquisition and other costs, as discussed above. Absent the effect of these items, adjusted operating income for the first nine months of 2006 increased $90 million from the prior year period, including a $32 million contribution to current period results from the variable annuity business acquired from Allstate. The contribution of the acquired Allstate business to adjusted operating income for the first nine months of 2006 consists of revenues of $127 million and benefits and expenses of $95 million. The remainder of the $90 million increase came primarily from higher fee income driven by higher average asset balances from market appreciation and net flows in our variable annuity account values. Partially offsetting these items was an increase in distribution costs charged to expense associated with increased variable annuity sales and account values and increased general expenses related to expansion initiatives. In addition, results for the first nine months of 2005 benefited $6 million, net of related amortization of deferred policy acquisition costs, from the collection of investment income on a previously defaulted bond.

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Revenues

2006 to 2005 Three Month Comparison. Revenues of the segment s individual life insurance business, as shown in the table above under Operating Results, decreased $135 million, from $602 million in the third quarter of 2005 to $467 million in the third quarter of 2006. Policy charges and fee income decreased $181