

PRUDENTIAL FINANCIAL INC

Form 10-Q

November 02, 2006

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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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

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**Prudential Financial, Inc.**

(Exact Name of Registrant as Specified in its Charter)

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

**22-3703799**  
**(I.R.S. Employer**

**Identification Number)**

**751 Broad Street**

**Newark, New Jersey 07102**

**(973) 802-6000**

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

As of 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
	<u>          </u>	<u>          </u>
<b>ASSETS</b>		
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
	<u>          </u>	<u>          </u>
Total investments	228,911	221,401
	<u>          </u>	<u>          </u>
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
	<u>          </u>	<u>          </u>
<b>TOTAL ASSETS</b>	<b>\$ 446,901</b>	<b>\$ 417,776</b>
	<u>          </u>	<u>          </u>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>LIABILITIES</b>		
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

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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
	<hr/>	<hr/>
Total liabilities	423,703	395,013
	<hr/>	<hr/>
<b>COMMITMENTS AND CONTINGENT LIABILITIES (See Note 10)</b>		
<b>STOCKHOLDERS EQUITY</b>		
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
	<hr/>	<hr/>
Total stockholders equity	23,198	22,763
	<hr/>	<hr/>
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 446,901</b>	<b>\$ 417,776</b>
	<hr/>	<hr/>

*See Notes to Unaudited Interim Consolidated Financial Statements*

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Unaudited Interim Consolidated Statements of Operations****Three and Nine Months Ended September 30, 2006 and 2005 (in millions, except per share amounts)**

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b>REVENUES</b>				
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
<b>Total revenues</b>	<b>8,476</b>	<b>7,791</b>	<b>23,823</b>	<b>23,845</b>
<b>BENEFITS AND EXPENSES</b>				
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
<b>Total benefits and expenses</b>	<b>6,928</b>	<b>6,673</b>	<b>20,570</b>	<b>20,096</b>
<b>INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES</b>				
	1,548	1,118	3,253	3,749
Income tax expense (benefit)	411	(261)	908	520
<b>INCOME FROM CONTINUING OPERATIONS</b>	<b>1,137</b>	<b>1,379</b>	<b>2,345</b>	<b>3,229</b>
Income (loss) from discontinued operations, net of taxes	68	(15)	46	(53)
<b>NET INCOME</b>	<b>\$ 1,205</b>	<b>\$ 1,364</b>	<b>\$ 2,391</b>	<b>\$ 3,176</b>
<b>EARNINGS PER SHARE (See Note 6)</b>				
<b>Financial Services Businesses</b>				
<b>Basic:</b>				
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)
<b>Net income per share of Common Stock</b>	<b>\$ 2.43</b>	<b>\$ 2.63</b>	<b>\$ 4.72</b>	<b>\$ 5.63</b>
<b>Diluted:</b>				
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)

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Net income per share of Common Stock	\$ 2.38	\$ 2.59	\$ 4.62	\$ 5.54
<b>Closed Block Business</b>				
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
<b>Balance, December 31, 2005</b>	\$ 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
<b>Balance, September 30, 2006</b>	\$ 6	\$	\$ 20,592	\$ 8,303	\$ (6,597)	\$ 894	\$ 23,198

*See Notes to Unaudited Interim Consolidated Financial Statements*

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Unaudited Interim Consolidated Statements of Cash Flows****Nine Months Ended September 30, 2006 and 2005 (in millions)**

	<u>2006</u>	<u>2005</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
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)
	<u>2,021</u>	<u>3,939</u>
<b>Cash flows from operating activities</b>		
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
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)
	<u>(3,964)</u>	<u>(6,942)</u>
<b>Cash flows used in investing activities</b>		
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
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)

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

*See Notes to Unaudited Interim Consolidated Financial Statements*

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**PRUDENTIAL FINANCIAL, INC.**

**Notes to Unaudited Interim Consolidated Financial Statements**

**1. BUSINESS AND BASIS OF PRESENTATION**

Prudential Financial, Inc. ( Prudential Financial ) and its subsidiaries (collectively, Prudential or the Company ) provide a wide range of insurance, investment management, and other financial products and services to both 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.

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**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

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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

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**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.

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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

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**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

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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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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:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	<b>(in millions)</b>			
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
<b>Income (loss) from discontinued operations before income taxes</b>	<b>100</b>	<b>(18)</b>	<b>70</b>	<b>(59)</b>
Income tax expense (benefit)	32	(3)	24	(6)
<b>Income (loss) from discontinued operations, net of taxes</b>	<b>\$ 68</b>	<b>\$ (15)</b>	<b>\$ 46</b>	<b>\$ (53)</b>



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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**PRUDENTIAL FINANCIAL, INC.**

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

**4. CLOSED BLOCK**

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

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

The excess of Closed Block Liabilities over Closed Block Assets at the date of the demutualization (adjusted to eliminate the impact of related amounts in Accumulated other comprehensive income (loss) ) represented the estimated maximum future earnings at that date from the Closed Block expected to result from operations attributed to the Closed Block after income taxes. In establishing the Closed Block, the Company developed an actuarial calculation of the timing of such maximum future earnings. If actual cumulative earnings of the Closed Block from inception through the end of any given period are greater than the expected cumulative earnings, only the expected earnings will be recognized in income. Any excess of actual cumulative earnings over expected cumulative earnings will represent undistributed accumulated earnings attributable to policyholders, which are recorded as a policyholder dividend obligation. The policyholder dividend obligation represents amounts to be paid to Closed Block policyholders as an additional policyholder dividend unless otherwise offset by future Closed Block performance that is less favorable than originally expected. If the actual cumulative earnings of the Closed Block from its inception through the end of any given period are less than the expected cumulative earnings of the Closed Block, the Company will recognize only the actual earnings in income. However, the Company may reduce policyholder dividend scales in the future, which would be intended to increase future actual earnings until the actual cumulative earnings equaled the expected cumulative earnings. 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)	
<b>Closed Block Liabilities</b>		
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
<b>Total Closed Block Liabilities</b>	<b>70,121</b>	<b>69,073</b>
<b>Closed Block Assets</b>		
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
<b>Total investments</b>	<b>63,908</b>	<b>62,947</b>
Cash and cash equivalents	2,078	2,167
Accrued investment income	713	658
Other Closed Block assets	406	286
<b>Total Closed Block Assets</b>	<b>67,105</b>	<b>66,058</b>
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)
<b>Future earnings to be recognized from Closed Block Assets and Closed Block Liabilities</b>	<b>\$ 3,066</b>	<b>\$ 3,115</b>

Information regarding the policyholder dividend obligation is as follows:

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	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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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)				
<b>Revenues</b>				
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
<b>Total Closed Block revenues</b>	<b>1,829</b>	<b>1,788</b>	<b>5,395</b>	<b>5,746</b>
<b>Benefits and Expenses</b>				
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
<b>Total Closed Block benefits and expenses</b>	<b>1,801</b>	<b>1,789</b>	<b>5,351</b>	<b>5,427</b>
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
<b>Closed Block revenues, net of Closed Block benefits and expenses and income taxes</b>	<b>\$ 0</b>	<b>\$ 17</b>	<b>\$ 39</b>	<b>\$ 218</b>

**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)			
<b>Balance, December 31, 2005</b>	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	
<b>Balance, September 30, 2006</b>	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

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

(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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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		
	Per			Per		
	Weighted Average Shares	Share Amount	Income	Weighted Average Shares	Per Share Amount	Income
	(in millions, except per share amounts)					
<b>Basic earnings per share</b>						
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
<b>Effect of dilutive securities and compensation programs</b>						
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
<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

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	Nine Months Ended September 30,					
	2006			2005		
	Per			Per		
	Income	Weighted Average Shares	Share Amount	Income	Weighted Average Shares	Share Amount
(in millions, except per share amounts)						
<b>Basic earnings per share</b>						
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
<b>Effect of dilutive securities and compensation programs</b>						
Stock options		6.9			5.7	
Deferred and long-term compensation programs		3.1			3.0	
<b>Diluted earnings per share</b>						
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**

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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

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**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:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
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
<b>Total</b>	<b>\$ 42</b>	<b>\$ 14</b>	<b>\$ 141</b>	<b>\$ 50</b>

***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**

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	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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## PRUDENTIAL FINANCIAL, INC.

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

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*



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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:

	<u>Restricted Stock Shares</u>	<u>Weighted Average Grant Date Fair Value</u>	<u>Restricted Stock Units</u>	<u>Weighted Average Grant Date Fair Value</u>	<u>Performance Shares(1)</u>	<u>Weighted Average Grant Date Fair Value</u>
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	<u>944,821</u>	<u>\$ 44.92</u>	<u>2,503,498</u>	<u>\$ 67.95</u>	<u>1,208,349</u>	<u>\$ 56.99</u>

- (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:

	<u>Restricted Stock Shares</u>	<u>Weighted Average Balance Sheet Date Fair Value</u>	<u>Restricted Stock Units</u>	<u>Weighted Average Balance Sheet Date Fair Value</u>
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

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Restricted at September 30, 2006	8,954	\$	76.25	125,599	\$	76.25
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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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**PRUDENTIAL FINANCIAL, INC.**

**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)			
<b>Components of net periodic (benefit) cost</b>				
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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	Nine Months Ended September 30,			
	Pension Benefits		Other Postretirement Benefits	
	2006	2005	2006	2005
	(in millions)			
<b>Components of net periodic (benefit) cost</b>				
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		
<b>Net periodic (benefit) cost</b>	<b>\$ (65)</b>	<b>\$ (118)</b>	<b>\$ 46</b>	<b>\$ 81</b>

**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.

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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.

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

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

Charges that relate to realized investment gains (losses), net, are also excluded from adjusted operating income. The related charges, 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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**PRUDENTIAL FINANCIAL, INC.**

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

Company's Corporate and Other operations execute forward currency contracts with third parties to sell the hedged currency in exchange for U.S. dollars at a specified exchange rate. The maturities of these contracts correspond with the future periods in which the 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:

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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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**PRUDENTIAL FINANCIAL, INC.**

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

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

source of earnings for this business and are included in adjusted operating income. In addition, Realized investment gains (losses), net from derivatives used to hedge certain foreign currency-denominated proprietary investments are included in adjusted operating income. Net realized investment gains of \$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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**PRUDENTIAL FINANCIAL, INC.**

**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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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
<b>Total Insurance Division</b>	<b>465</b>	<b>341</b>	<b>1,010</b>	<b>862</b>
Asset Management	100	116	406	355
Financial Advisory	43	31	14	(51)
Retirement	109	110	388	407
<b>Total Investment Division</b>	<b>252</b>	<b>257</b>	<b>808</b>	<b>711</b>
International Insurance	397	358	1,059	970
International Investments	31	25	109	69
<b>Total International Insurance and Investments Division</b>	<b>428</b>	<b>383</b>	<b>1,168</b>	<b>1,039</b>
Corporate Operations	(21)	7	3	41
Real Estate and Relocation Services	36	43	75	85
<b>Total Corporate and Other</b>	<b>15</b>	<b>50</b>	<b>78</b>	<b>126</b>
<b>Adjusted Operating Income before income taxes for Financial Services Businesses</b>	<b>1,160</b>	<b>1,031</b>	<b>3,064</b>	<b>2,738</b>
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)
<b>Income from continuing operations before income taxes for Financial Services Businesses</b>	<b>1,474</b>	<b>1,057</b>	<b>3,057</b>	<b>3,245</b>
<b>Income from continuing operations before income taxes for Closed Block Business</b>	<b>74</b>	<b>61</b>	<b>196</b>	<b>504</b>

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Income from continuing operations before income taxes	<u>\$ 1,548</u>	<u>\$ 1,118</u>	<u>\$ 3,253</u>	<u>\$ 3,749</u>
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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.



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

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

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	(in millions)			
<b>Financial Services Businesses:</b>				
Individual Life and Annuities	\$ 1,050	\$ 1,043	\$ 3,116	\$ 2,967
Group Insurance	1,155	1,038	3,381	3,150
<b>Total Insurance Division</b>	<b>2,205</b>	<b>2,081</b>	<b>6,497</b>	<b>6,117</b>
<b>Asset Management</b>	<b>443</b>	<b>441</b>	<b>1,414</b>	<b>1,260</b>
Financial Advisory	126	122	432	329
Retirement	1,112	1,047	3,215	3,002
<b>Total Investment Division</b>	<b>1,681</b>	<b>1,610</b>	<b>5,061</b>	<b>4,591</b>
<b>International Insurance</b>	<b>1,924</b>	<b>1,954</b>	<b>5,807</b>	<b>5,782</b>
International Investments	132	122	428	356
<b>Total International Insurance and Investments Division</b>	<b>2,056</b>	<b>2,076</b>	<b>6,235</b>	<b>6,138</b>
<b>Corporate Operations</b>	<b>72</b>	<b>66</b>	<b>229</b>	<b>136</b>
Real Estate and Relocation Services	93	100	246	256
<b>Total Corporate and Other</b>	<b>165</b>	<b>166</b>	<b>475</b>	<b>392</b>
<b>Total</b>	<b>6,107</b>	<b>5,933</b>	<b>18,268</b>	<b>17,238</b>
<b>Items excluded from Adjusted Operating Income:</b>				
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
<b>Total Financial Services Businesses</b>	<b>6,587</b>	<b>5,926</b>	<b>18,234</b>	<b>17,882</b>
<b>Closed Block Business</b>	<b>1,889</b>	<b>1,865</b>	<b>5,589</b>	<b>5,963</b>

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

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

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

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

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

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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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**PRUDENTIAL FINANCIAL, INC.**

**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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**Table of Contents****PRUDENTIAL FINANCIAL, INC.****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.

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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.



**Table of Contents****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



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**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.

**Table of Contents****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
<b>ASSETS</b>						
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
<b>Total investments</b>	<b>160,306</b>	<b>68,605</b>	<b>228,911</b>	<b>153,905</b>	<b>67,496</b>	<b>221,401</b>
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
<b>TOTAL ASSETS</b>	<b>\$ 373,386</b>	<b>\$ 73,515</b>	<b>\$ 446,901</b>	<b>\$ 345,291</b>	<b>\$ 72,485</b>	<b>\$ 417,776</b>
<b>LIABILITIES AND ATTRIBUTED EQUITY</b>						
<b>LIABILITIES</b>						
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



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Total liabilities	351,333	72,370	423,703	323,637	71,376	395,013
<b>COMMITMENTS AND CONTINGENT LIABILITIES</b>						
<b>ATTRIBUTED EQUITY</b>						
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
<b>TOTAL LIABILITIES AND ATTRIBUTED EQUITY</b>	<b>\$ 373,386</b>	<b>\$ 73,515</b>	<b>\$ 446,901</b>	<b>\$ 345,291</b>	<b>\$ 72,485</b>	<b>\$ 417,776</b>

*See Notes to Unaudited Interim Supplemental Combining Financial Information*

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Unaudited Interim Supplemental Combining Statements of Operations****For the three months ended 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
<b>REVENUES</b>						
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
<b>Total revenues</b>	<b>6,587</b>	<b>1,889</b>	<b>8,476</b>	<b>5,926</b>	<b>1,865</b>	<b>7,791</b>
<b>BENEFITS AND EXPENSES</b>						
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
<b>Total benefits and expenses</b>	<b>5,113</b>	<b>1,815</b>	<b>6,928</b>	<b>4,869</b>	<b>1,804</b>	<b>6,673</b>
<b>INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES</b>						
	1,474	74	1,548	1,057	61	1,118
Income tax expense (benefit)	390	21	411	(280)	19	(261)
<b>INCOME FROM CONTINUING OPERATIONS</b>	<b>1,084</b>	<b>53</b>	<b>1,137</b>	<b>1,337</b>	<b>42</b>	<b>1,379</b>
Income (loss) from discontinued operations, net of taxes	68		68	(15)		(15)
<b>NET INCOME</b>	<b>\$ 1,152</b>	<b>\$ 53</b>	<b>\$ 1,205</b>	<b>\$ 1,322</b>	<b>\$ 42</b>	<b>\$ 1,364</b>

*See Notes to Unaudited Interim Supplemental Combining Financial Information*

**Table of Contents****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
<b>REVENUES</b>						
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
<b>Total revenues</b>	<b>18,234</b>	<b>5,589</b>	<b>23,823</b>	<b>17,882</b>	<b>5,963</b>	<b>23,845</b>
<b>BENEFITS AND EXPENSES</b>						
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
<b>Total benefits and expenses</b>	<b>15,177</b>	<b>5,393</b>	<b>20,570</b>	<b>14,637</b>	<b>5,459</b>	<b>20,096</b>
<b>INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES</b>						
	3,057	196	3,253	3,245	504	3,749
Income tax expense	852	56	908	350	170	520
<b>INCOME FROM CONTINUING OPERATIONS</b>	<b>2,205</b>	<b>140</b>	<b>2,345</b>	<b>2,895</b>	<b>334</b>	<b>3,229</b>
Income (loss) from discontinued operations, net of taxes	46		46	(53)		(53)
<b>NET INCOME</b>	<b>\$ 2,251</b>	<b>\$ 140</b>	<b>\$ 2,391</b>	<b>\$ 2,842</b>	<b>\$ 334</b>	<b>\$ 3,176</b>

*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.

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

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

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**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



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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

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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		Nine Months Ended	
	September 30,		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

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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		Nine Months Ended	
	September 30,		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)

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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.

**Table of Contents****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.

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

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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.

**Table of Contents***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 million, including \$190 million due to an update of our assumptions related to the amortization of unearned revenue reserves, which was more than offset by a decrease in amortization of deferred policy acquisition costs net of an increase in change in reserves, as discussed above. Partially offsetting this decrease in revenues was an increase in premiums of \$12 million, primarily due to increased renewal premiums on term life insurance reflecting continued growth of our in force block of term insurance products. Net investment income increased \$13 million, reflecting higher assets in the general account and improved yields in the third quarter of 2006. Other income increased \$21 million reflecting a \$20 million increase to adjusted operating income from compensation received based on multi-year profitability of third-party products we distribute as discussed above.

Revenues from the segment's individual annuity business increased \$142 million, from \$441 million in the third quarter of 2005 to \$583 million in the third quarter of 2006, including revenues of \$99 million from the Allstate business acquired during the second quarter of 2006. Policy charges and fees increased \$85 million, including \$61 million from the business acquired from Allstate. The increase in policy charges and fees, excluding the contribution from the Allstate business, reflects an increase in the average market value of variable annuity account values. Asset management fees and other income increased \$31 million, including \$15 million from the business acquired from Allstate, primarily due to an increase in asset based fees driven by appreciating markets.

*2006 to 2005 Nine Month Comparison.* Revenues of the segment's individual life insurance business decreased \$71 million, from \$1.682 billion in the first nine months of 2005 to \$1.611 billion in the first nine months of 2006. Policy charges and fee income decreased \$165 million, including \$190 million due to an update of our assumptions related to amortization of unearned revenue reserves, as discussed above. Partially offsetting this decrease in revenues was an increase in premiums of \$30 million, primarily due to increased renewal premiums on term life insurance reflecting continued growth of our in force block of term insurance products. Net investment income increased \$33 million, reflecting higher assets and improved yields in 2006. This increase was partially offset by the collection of investment income on a previously defaulted bond in the first nine months of 2005. Asset management fees and other income increased \$31 million, including the benefit to adjusted operating income from compensation received based on multi-year profitability of third-party products we distribute as discussed above. The remainder of the increase reflects higher asset based fees due to higher asset balances.

Revenues from the segment's individual annuity business increased \$220 million, from \$1.285 billion in the first nine months of 2005 to \$1.505 billion in the first nine months of 2006, including revenues of \$127 million from the Allstate business acquired during the second quarter of 2006. Policy charges and fees increased \$164 million, including \$79 million from the business acquired from Allstate. The increase in policy charges and fees, excluding the contribution from the Allstate business, reflects an increase in the average market value of variable annuity account values and positive net flows in our variable annuities, including an increase in account values with living benefit options. Asset management fees and other income increased \$52 million, including \$18 million from the business acquired from Allstate. The increase in asset management fees and other income, excluding the contribution from the Allstate business, was primarily due to an increase in asset based fees driven by appreciating markets. In addition, revenues in the prior year included the collection of investment income on a previously defaulted bond

*Benefits and Expenses*

*2006 to 2005 Three Month Comparison.* Benefits and expenses of the segment's individual life insurance business, as shown in the table above under Operating Results, decreased \$198 million, from \$482 million in the third quarter of 2005 to \$284 million in the third quarter of 2006. Amortization of deferred policy acquisition



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costs decreased \$372 million, including \$378 million due to an update of our assumptions, as discussed above. Policyholders' benefits, including interest credited to policyholders' account balances, increased \$175 million, including \$142 million due to the update of assumptions and methodology refinements to certain reserves, growth in our in force block of term insurance products, as well as less favorable mortality experience compared to the prior year period.

Benefits and expenses of the segment's individual annuity business increased \$111 million, from \$280 million in the third quarter of 2005 to \$391 million in the third quarter of 2006, including benefits and expenses of \$75 million from the Allstate business acquired during the second quarter of 2006. Policyholders' benefits, including interest credited to policyholders' account balances, increased \$56 million, including \$25 million from the business acquired from Allstate. Results for the third quarter of 2005 included a \$38 million benefit from the increased estimate of total gross profits and decreased cost of actual and expected death claims while the current period includes a benefit of \$5 million as discussed above. General and administrative expenses, net of capitalization, increased \$48 million, including \$50 million from the business acquired from Allstate. Results for the third quarter of 2005 included a \$13 million increase in the amortization of value of business acquired in conjunction with the modeling refinements discussed above. The remainder of the increase in general and administrative expenses, excluding the contribution from the Allstate business, reflects increased distribution costs charged to expense associated with increased variable annuity sales and increased general expenses related to growth of the business. Both the current and prior year periods include a \$32 million benefit from a reduction in amortization of deferred policy acquisition costs as discussed above.

*2006 to 2005 Nine Month Comparison.* Benefits and expenses of the segment's individual life insurance business decreased \$127 million, from \$1.326 billion in the first nine months of 2005 to \$1.199 billion in the first nine months of 2006. Amortization of deferred policy acquisition costs decreased \$349 million, including \$378 million due to an update of our assumptions, as discussed above. Policyholders' benefits, including interest credited to policyholders' account balances, increased \$224 million, including \$142 million due to the update of assumptions and methodology refinements to certain reserves, growth in our in force block of term insurance products, as well as less favorable mortality experience compared to the prior year period.

Benefits and expenses of the segment's individual annuity business increased \$150 million, from \$923 million in the first nine months of 2005 to \$1.073 billion in the first nine months of 2006, including benefits and expenses of \$95 million from the Allstate business acquired during the second quarter of 2006. General and administrative expenses, net of capitalization, increased \$97 million, including \$61 million from the business acquired from Allstate. Results for the third quarter of 2005 included a \$13 million increase in the amortization of value of business acquired in conjunction with the modeling refinements discussed above. The remainder of the increase in general and administrative expenses, excluding the contribution from the Allstate business, reflects increased distribution costs charged to expense associated with increased variable annuity sales, increased general expenses related to expansion initiatives and growth of the business, and increased asset management costs associated with the growth in variable annuity account values. Policyholders' benefits, including interest credited to policyholders' account balances, increased \$38 million, including \$34 million in the current year from the business acquired from Allstate. Results for the third quarter of 2005 included a \$38 million benefit from the increased estimate of total gross profits and decreased cost of actual and expected death claims while the current period includes a benefit of \$5 million, as discussed above. Absent these items, policyholders' benefits for the first nine months of 2006, excluding the contribution from the Allstate business, decreased from the first nine months of 2005 reflecting lower costs of our guaranteed benefits resulting from reduction in our net amount at risk and a benefit in the current period from an update of assumptions. Both the current and prior year periods include a \$32 million benefit from a reduction in amortization of deferred policy acquisition costs as discussed above.

*Sales Results and Account Values*

The following table sets forth individual life insurance business sales, as measured by scheduled premiums from new sales on an annualized basis and first year excess premiums and deposits on a cash-received basis, and





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changes in account values for the individual annuity business, for the periods indicated. Sales of the individual life insurance business do not correspond to revenues under U.S. GAAP. They are, however, a relevant measure of business activity. In managing our individual life insurance business, we analyze new sales on this basis because it measures the current sales performance of the business, while revenues primarily reflect the renewal persistency and aging of in force policies written in prior years and net investment income as well as current sales. For our individual annuity business, assets are reported at account value, and net sales (redemptions) are gross sales minus redemptions or surrenders and withdrawals, as applicable.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
	(in millions)			
<b>Life insurance sales(1):</b>				
Excluding corporate-owned life insurance:				
Variable life	\$ 25	\$ 19	\$ 70	\$ 56
Universal life	34	54	117	158
Term life	35	30	100	89
	<u>94</u>	<u>103</u>	<u>287</u>	<u>303</u>
Total excluding corporate-owned life insurance				
Corporate-owned life insurance	5	3	10	5
	<u>99</u>	<u>106</u>	<u>297</u>	<u>308</u>
Total				
<b>Life Insurance sales by distribution channel, excluding corporate-owned life insurance(1):</b>				
Prudential Agents	\$ 37	\$ 48	\$ 127	\$ 162
Third party	57	55	160	141
	<u>94</u>	<u>103</u>	<u>287</u>	<u>303</u>
Total				
<b>Variable Annuities(2):</b>				
Beginning total account value	\$ 68,807	\$ 47,402	\$ 50,778	\$ 47,418
Sales	2,323	1,930	6,952	5,142
Surrenders and withdrawals	(2,084)	(1,397)	(5,426)	(4,255)
	<u>239</u>	<u>533</u>	<u>1,526</u>	<u>887</u>
Net sales				
Benefit payments	(244)	(179)	(654)	(520)
	<u>(5)</u>	<u>354</u>	<u>872</u>	<u>367</u>
Net flows				
Change in market value, interest credited and other activity	2,012	1,904	3,240	2,193
Policy charges	(259)	(176)	(647)	(494)
Acquisition			16,312	
	<u>70,555</u>	<u>49,484</u>	<u>70,555</u>	<u>49,484</u>
Ending total account value				
<b>Fixed Annuities:</b>				
Beginning total account value	\$ 3,871	\$ 4,064	\$ 3,991	\$ 3,879
Sales	33	39	93	334
Surrenders and withdrawals	(75)	(56)	(236)	(165)
	<u>33</u>	<u>39</u>	<u>93</u>	<u>334</u>

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Net sales (redemptions)	(42)	(17)	(143)	169
Benefit payments	(41)	(35)	(126)	(119)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Net flows	(83)	(52)	(269)	50
Interest credited and other activity	27	22	95	108
Policy charges	(1)	(1)	(3)	(4)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Ending total account value	\$ 3,814	\$ 4,033	\$ 3,814	\$ 4,033
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

- 
- (1) Scheduled premiums from new sales on an annualized basis and first year excess premiums and deposits on a cash-received basis.
- (2) Variable annuities include only those sold as retail investment products. Investments through defined contribution plan products are not included and are included with defined contribution plan products.

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*2006 to 2005 Three Month Comparison.* Sales of new life insurance, excluding corporate-owned life insurance, measured as described above, decreased \$9 million, from \$103 million in the third quarter of 2005 to \$94 million in the third quarter of 2006. Sales of our universal life products decreased \$20 million. This decrease was partially offset by increased sales of \$11 million of our variable and term life products.

Sales of life insurance by Prudential Agents decreased \$11 million, reflecting a decline in the number of agents from 3,212 at September 30, 2005 to 2,814 at September 30, 2006, which impacted all life insurance product lines. Sales from the third party distribution channel increased \$2 million, reflecting increased variable and term life sales, partially offset by decreased universal life sales driven by lower large case activity.

Total account values for fixed and variable annuities amounted to \$74.4 billion as of September 30, 2006, an increase of \$1.7 billion from June 30, 2006, primarily reflecting increases in the market value of customers' variable annuities. Total account values as of September 30, 2006 increased \$20.9 billion from September 30, 2005, primarily reflecting the \$16.3 billion of variable annuity account values acquired from Allstate, as well as increases in the market value of customers' variable annuities combined with increased variable annuity net sales. Individual variable annuity gross sales increased by \$393 million, from \$1.9 billion in the third quarter of 2005 to \$2.3 billion in the third quarter of 2006, reflecting sales of \$360 million related to the business acquired from Allstate. Individual variable annuity surrenders and withdrawals increased by \$687 million, from \$1.4 billion in the third quarter of 2005 to \$2.1 billion in the third quarter of 2006, including \$531 million of surrenders and withdrawals in the current quarter related to the business acquired from Allstate.

*2006 to 2005 Nine Month Comparison.* Sales of new life insurance, excluding corporate-owned life insurance, measured as described above, decreased \$16 million, from \$303 million in the first nine months of 2005 to \$287 million in the first nine months of 2006. Sales of our universal life products decreased \$41 million. This decrease was partially offset by increased sales of our variable and term life products.

Sales of life insurance by Prudential Agents decreased \$35 million, reflecting a decline in the number of agents from 3,212 at September 30, 2005 to 2,814 at September 30, 2006, which impacted all life insurance product lines. Sales from the third party distribution channel increased \$19 million, reflecting increased variable and term life sales, partially offset by decreased universal life sales driven by lower large case activity.

Total account values for fixed and variable annuities amounted to \$74.4 billion as of September 30, 2006, an increase of \$19.6 billion from December 31, 2005, primarily reflecting \$16.3 billion of variable annuity account values acquired from Allstate, as well as increases in the market value of customers' variable annuities and variable annuity net flows. Total account values as of September 30, 2006 increased \$20.9 billion from September 30, 2005, primarily reflecting the \$16.3 billion of variable annuity account values acquired from Allstate, as well as increases in the market value of customers' variable annuities combined with variable annuity net flows. Individual variable annuity gross sales increased by \$1.8 billion, from \$5.1 billion in the first nine months of 2005 to \$6.9 billion in the first nine months of 2006, reflecting increased sales from our living benefit product features that were first introduced in the first quarter of 2005, growth of our distribution relationships, our retirement marketing strategy and sales of \$491 million related to the business acquired from Allstate. Individual variable annuity surrenders and withdrawals increased by \$1.2 billion, from \$4.2 billion in the first nine months of 2005 to \$5.4 billion in the first nine months of 2006, including \$696 million of surrenders and withdrawals in the current year period related to the business acquired from Allstate.

**Table of Contents***Policy Surrender Experience*

The following table sets forth the individual life insurance business's policy surrender experience for variable and universal life insurance, measured by cash value of surrenders, for the periods indicated. These amounts do not correspond to expenses under U.S. GAAP. In managing this business, we analyze the cash value of surrenders because it is a measure of the degree to which policyholders are maintaining their in force business with us, a driver of future profitability. Our term life insurance products do not provide for cash surrender values.

	Three Months		Nine Months	
	Ended		Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
	(in millions)			
Cash value of surrenders	\$ 181	\$ 214	\$ 584	\$ 535
Cash value of surrenders as a percentage of mean future benefit reserves, policyholders' account balances, and separate account balances	3.4%	4.3%	3.7%	3.6%

*2006 to 2005 Three Month Comparison.* The total cash value of surrenders decreased \$33 million, from \$214 million in the third quarter of 2005 to \$181 million in the third quarter of 2006, resulting in a decrease in the level of surrenders as a percentage of mean future policy benefit reserves, policyholders' account balances and separate account balances. The decrease reflects the surrender of two large corporate-owned life insurance cases during the third quarter of 2005.

*2006 to 2005 Nine Month Comparison.* The total cash value of surrenders increased \$49 million, from \$535 million in the first nine months of 2005 to \$584 million in the first nine months of 2006, resulting in a slight increase in the level of surrenders as a percentage of mean future policy benefit reserves, policyholders' account balances and separate account balances. The increase is driven by an increase in surrenders of variable corporate-owned life insurance in the first nine months of 2006 compared to the prior year period.

**Group Insurance***Operating Results*

The following table sets forth the Group Insurance segment's operating results for the periods indicated.

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	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
	(in millions)			
<b>Operating results:</b>				
Revenues	\$ 1,155	\$ 1,038	\$ 3,381	\$ 3,150
Benefits and expenses	1,065	978	3,215	3,006
Adjusted operating income	90	60	166	144
Realized investment gains (losses), net, and related adjustments(1)	(7)	24	(17)	69
Related charges(2)		(1)	(1)	(1)
Income from continuing operations before income taxes	\$ 83	\$ 83	\$ 148	\$ 212

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

(2) Benefits and expenses exclude related charges which represent the unfavorable (favorable) impact of Realized investment gains (losses), net, on interest credited to policyholders' account balances.

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**Table of Contents***Adjusted Operating Income*

*2006 to 2005 Three Month Comparison.* Adjusted operating income increased \$30 million, from \$60 million in the third quarter of 2005 to \$90 million in the third quarter of 2006. Reflected in this increase is an \$11 million benefit from refinements in group disability reserves as a result of annual reviews. These annual reviews benefited the current year quarter \$19 million, primarily associated with our long-term care products, while benefiting the prior year quarter \$8 million. Also contributing to this increase were more favorable claims experience in our group disability business, growth in our group life business and an increased contribution from investment results, reflecting growth in invested assets and higher interest rates on shorter-term investments. Partially offsetting these increases were higher operating expenses in the current year quarter due to growth in the business.

*2006 to 2005 Nine Month Comparison.* Adjusted operating income increased \$22 million, from \$144 million in the first nine months of 2005 to \$166 million in the first nine months of 2006. This increase reflects more favorable claims experience in our group disability business, an increased contribution from investment results, reflecting growth in invested assets and increased interest rates on shorter-term investments, and the benefit from the reserve refinements in our group disability business discussed above. Partially offsetting these increases were less favorable claims experience in our group life business and higher operating expenses in the current year period due to growth in the business.

*Revenues*

*2006 to 2005 Three Month Comparison.* Revenues, as shown in the table above under Operating Results, increased \$117 million, from \$1.038 billion in the third quarter of 2005 to \$1.155 billion in the third quarter of 2006. Group life premiums increased \$79 million, from \$622 million in the third quarter of 2005 to \$701 million in the third quarter of 2006, primarily reflecting growth in business in force resulting from new sales and continued strong persistency. Group disability premiums, which include long-term care products, increased \$11 million, from \$180 million in the third quarter of 2005 to \$191 million in the third quarter of 2006, primarily reflecting growth in business in force resulting from new sales and continued strong persistency. Net investment income also increased \$11 million reflecting a larger base of invested assets due primarily to business growth, as well as higher interest rates on shorter-term investments.

*2006 to 2005 Nine Month Comparison.* Revenues increased \$231 million, from \$3.150 billion in the first nine months of 2005 to \$3.381 billion in the first nine months of 2006. Group life premiums increased \$168 million, from \$1.908 billion in the first nine months of 2005 to \$2.076 billion in the first nine months of 2006, primarily reflecting growth in business in force resulting from new sales and continued strong persistency, which decreased slightly from 96% in the first nine months of 2005 to 95% in the first nine months of 2006. Group disability premiums, which include long-term care products, increased \$24 million, from \$545 million in the first nine months of 2005 to \$569 million in the first nine months of 2006, primarily reflecting growth in business in force resulting from new sales and continued strong persistency, which improved from 87% in the first nine months of 2005 to 91% in the first nine months of 2006. Net investment income also increased \$15 million reflecting a larger base of invested assets due primarily to business growth, as well as higher interest rates on shorter-term investments.

**Table of Contents***Benefits and Expenses*

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
<b>Benefits ratio(1):</b>				
Group life	89.8%	89.5%	92.4%	89.7%
Group disability	79.5	91.3	85.4	96.2
<b>Administrative operating expense ratio(2):</b>				
Group life	10.0	10.3	9.0	9.6
Group disability	20.5	20.7	21.2	20.6

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

*2006 to 2005 Three Month Comparison.* Benefits and expenses, as shown in the table above under Operating Results, increased \$87 million, from \$978 million in the third quarter of 2005 to \$1.065 billion in the third quarter of 2006. The increase was primarily driven by an increase of \$70 million in policyholders' benefits, including the change in policy reserves, primarily reflecting the growth of business in force, partially offset by more favorable claims experience in our group disability business and the benefit from the reserve refinements discussed above. Also contributing to the increase in benefits and expenses were higher operating expenses as a result of growth in the business.

The group life benefits ratio was relatively unchanged from the third quarter of 2005 to the third quarter of 2006, as the claims experience in our group life business was relatively stable. The group disability benefits ratio improved by 11.8 percentage points from the third quarter of 2005 to the third quarter of 2006, due to more favorable claims experience and the benefit from the reserve refinements discussed above. Excluding the effect of the reserve refinements, the group disability benefits ratio improved by 6.3 percentage points from the third quarter of 2005 to the third quarter of 2006. The group life and group disability administrative operating expense ratios were both relatively unchanged from the third quarter of 2005 to the third quarter of 2006, as the increase in operating expenses was commensurate with the related increase in revenue from growth in the business.

*2006 to 2005 Nine Month Comparison.* Benefits and expenses increased \$209 million, from \$3.006 billion in the first nine months of 2005 to \$3.215 billion in the first nine months of 2006. The increase was primarily driven by an increase of \$179 million in policyholders' benefits, including the change in policy reserves, reflecting the growth of business in force and less favorable claims experience in our group life business, partially offset by more favorable claims experience in our group disability business and the benefit from the reserve refinements discussed above. Also contributing to the increase in benefits and expenses were higher operating expenses as a result of growth in the business.

The group life benefits ratio deteriorated 2.7 percentage points from the first nine months of 2005 to the first nine months of 2006, reflecting less favorable claims experience in our group life business. The group disability benefits ratio improved by 10.8 percentage points from the first nine months of 2005 to the first nine months of 2006, due to more favorable claims experience in our group disability business and the benefit from the reserve refinements discussed above. Excluding the effect of the reserve refinements, the group disability benefits ratio improved by 9.3

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percentage points from the first nine months of 2005 to the first nine months of 2006. The group life administrative operating expense ratio improved from the first nine months of 2005 to the first nine months of 2006, reflecting relatively stable expenses with an increasing level of revenue. The group disability administrative operating expense ratio deteriorated from the first nine months of 2005 to the first nine months of 2006, reflecting slightly higher operating expenses in the current year.



**Table of Contents***Sales Results*

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

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	(in millions)			
<b>New annualized premiums(1):</b>				
Group life	\$ 98	\$ 32	\$ 329	\$ 336
Group disability(2)	29	15	121	137
<b>Total</b>	<b>\$ 127</b>	<b>\$ 47</b>	<b>\$ 450</b>	<b>\$ 473</b>

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

(2) Includes long-term care products.

*2006 to 2005 Three Month Comparison.* Total new annualized premiums increased \$80 million, from \$47 million in the third quarter of 2005 to \$127 million in the third quarter of 2006. This increase is primarily attributable to several large sales in both our group life and group disability business during the current year quarter.

*2006 to 2005 Nine Month Comparison.* Total new annualized premiums decreased \$23 million, from \$473 million in the first nine months of 2005 to \$450 million in the first nine months of 2006. This decrease is primarily attributable to a significant large case sale in the group life business in the first quarter of 2005.

**Investment Division***Asset Management**Operating Results*

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The following table sets forth the Asset Management segment's operating results for the periods indicated.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
	(in millions)			
<b>Operating results:</b>				
Revenues	\$ 443	\$ 441	\$ 1,414	\$ 1,260
Expenses	343	325	1,008	905
Adjusted operating income	100	116	406	355
Realized investment gains (losses), net, and related adjustments(1)	(5)	1	(5)	1
Income from continuing operations before income taxes	\$ 95	\$ 117	\$ 401	\$ 356

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

**Table of Contents***Adjusted Operating Income*

*2006 to 2005 Three Month Comparison.* Adjusted operating income decreased \$16 million, from \$116 million in the third quarter of 2005 to \$100 million in the third quarter of 2006. The decrease in adjusted operating income reflects decreased income from our commercial mortgage operations, primarily due to changes in value of hedging instruments, as well as charges in the current quarter totaling \$8 million related to a write-down in value of intangible assets. Partially offsetting these items were increased asset management fees of \$16 million primarily from institutional customer assets as a result of increased asset values due to market appreciation and net asset inflows.

*2006 to 2005 Nine Month Comparison.* Adjusted operating income increased \$51 million, from \$355 million in the first nine months of 2005 to \$406 million in the first nine months of 2006. Current period results benefited from increased fees of \$62 million, primarily from institutional customer assets as a result of increased asset values due to market appreciation and net asset inflows. In addition, proprietary investing income and performance based incentive fees benefited \$41 million primarily from appreciation and gains on sale of real estate related investments, including income of \$23 million relating to a single investment in the current period. Proprietary investing income for the first nine months of 2005 included \$58 million relating to two sale transactions. Increased performance-related compensation costs in the current year period partially offset the foregoing growth in revenues.

*Revenues*

The following tables set forth the Asset Management segment's revenues, presented on a basis consistent with the table above under Operating Results, by type, asset management fees by source and assets under management for the periods indicated. In managing our business we analyze assets under management, which do not correspond to U.S. GAAP assets, because a principal source of our revenues are fees based on assets under management. The presentation of revenues below has been revised from the presentation in prior period reports to reflect revenues by type.

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	(in millions)			
<b>Revenues by type:</b>				
Asset management fees	\$ 244	\$ 228	\$ 715	\$ 653
Incentive, transaction, principal investing and capital markets revenues	79	99	334	257
Service, distribution, and other revenues(1)	120	114	365	350
<b>Total revenues</b>	<b>\$ 443</b>	<b>\$ 441</b>	<b>\$ 1,414</b>	<b>\$ 1,260</b>

- (1) Includes revenues under a contractual arrangement with Wachovia Securities, related to managed account services, which was originally scheduled to expire on July 1, 2006. This contract was amended effective July 1, 2005 to provide essentially a fixed fee for managed account services and is now scheduled to expire on July 1, 2008.

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	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
(in millions)				
<b>Asset management fees by source:</b>				
Institutional customers	\$ 111	\$ 94	\$ 311	\$ 262
Retail customers(1)	75	74	227	213
General account	58	60	177	178
<b>Total asset management fees</b>	<b>\$ 244</b>	<b>\$ 228</b>	<b>\$ 715</b>	<b>\$ 653</b>

- (1) Consists of individual mutual funds and both variable annuities and variable life insurance asset management revenues from our separate accounts. This also includes funds invested in proprietary mutual funds through our defined contribution plan products. Revenues from fixed annuities and the fixed rate options of both variable annuities and variable life insurance are included in the general account.

	September 30,	September 30,
	2006	2005
(in billions)		
<b>Assets Under Management (at fair market value):</b>		
Institutional customers(1)	\$ 147.9	\$ 129.8
Retail customers(2)	75.9	70.5
General account	163.8	156.3
<b>Total</b>	<b>\$ 387.6</b>	<b>\$ 356.6</b>

- (1) Consists of third party institutional assets and group insurance contracts.
- (2) Consists of individual mutual funds, including investments in our mutual funds through wrap-fee products, and both variable annuities and variable life insurance assets in our separate accounts. This also includes funds invested in proprietary mutual funds through our defined contribution plan products. Fixed annuities and the fixed rate options of both variable annuities and variable life insurance are included in the general account.

*2006 to 2005 Three Month Comparison.* Revenues, as shown in the table above under Operating Results, increased \$2 million, from \$441 million in the third quarter of 2005 to \$443 million in the third quarter of 2006. The current quarter benefited from increased asset management fees of \$16 million primarily from institutional customer assets as a result of increased asset values due to market appreciation and net asset flows. Revenues in the third quarter of 2006 also benefited from increased revenues of \$13 million from proprietary investing activities. Essentially offsetting the foregoing growth in revenues are decreased revenues from our commercial mortgage operations, primarily due to changes in value of hedging instruments and decreased performance based incentive and transaction fees of \$11 million mainly related to our real estate management.

*2006 to 2005 Nine Month Comparison.* Revenues increased \$154 million, from \$1.260 billion in the first nine months of 2005 to \$1.414 billion in the first nine months of 2006. This increase was primarily the result of a \$62 million increase in asset management fees mainly from institutional customer assets as a result of increased asset values due to market appreciation and net asset flows. Revenues in the current period also benefited from increased revenues of \$38 million from proprietary investing due to appreciation and gains on sale of real estate related investments, including income of \$12 million relating to a single investment in the current period and \$58 million relating to two sale

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transactions in the prior year period. Additionally, current period results include increased performance based incentive fees of \$32 million mainly related to our real estate management.

### *Expenses*

*2006 to 2005 Three Month Comparison.* Expenses, as shown in the table above under Operating Results, increased \$18 million, from \$325 million in the third quarter of 2005 to \$343 million in the third

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quarter of 2006. The increase in expenses was primarily due to charges in the current quarter totaling \$8 million related to a write-down in value of intangible assets, and expenses associated with minority interests in certain investments.

*2006 to 2005 Nine Month Comparison.* Expenses increased \$103 million, from \$905 million in the first nine months of 2005 to \$1.008 billion in the first nine months of 2006. The increase in expenses is primarily due to higher performance-based compensation costs resulting from favorable performance in the first nine months of 2006, higher expenses related to proprietary investing activities, and charges in the current period totaling \$8 million related to a write-down in value of intangible assets.

**Financial Advisory***Operating Results*

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

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	(in millions)			
<b>Operating results:</b>				
Revenues	\$ 126	\$ 122	\$ 432	\$ 329
Expenses	83	91	418	380
Adjusted operating income(1)	\$ 43	\$ 31	\$ 14	\$ (51)

(1) Results of this segment are the same on both an adjusted operating income basis and a U.S. GAAP basis.

On July 1, 2003, we combined our retail securities brokerage and clearing operations with those of Wachovia Corporation, or Wachovia, and formed Wachovia Securities Financial Holdings, LLC, or Wachovia Securities, a joint venture headquartered in Richmond, Virginia. We have a 38% ownership interest in the joint venture, while Wachovia owns the remaining 62%. The transaction included our securities brokerage operations but did not include our equity sales, trading and research operations. As part of the transaction we retained certain assets and liabilities related to the contributed businesses, including liabilities for certain litigation and regulatory matters. We account for our 38% ownership of the joint venture under the equity method of accounting.

*2006 to 2005 Three Month Comparison.* Adjusted operating income increased \$12 million, from \$31 million in the third quarter of 2005 to \$43 million in the third quarter of 2006. The segment's results for the third quarter of 2006 include our share of earnings from Wachovia Securities, on a pre-tax basis, which increased to \$73 million in the current quarter from \$59 million in the third quarter of 2005 reflecting the joint venture's increased fee income. The segment's results include expenses of \$22 million in both the third quarter of 2006 and the third quarter of 2005 related to obligations and costs we retained in connection with the contributed businesses primarily for litigation and regulatory matters. In

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addition, results of the segment include losses from our equity sales and trading operations of \$8 million in the third quarter of 2006 and \$6 million in the third quarter of 2005.

*2006 to 2005 Nine Month Comparison.* Adjusted operating income increased \$65 million, from a loss of \$51 million in the first nine months of 2005 to income of \$14 million in the first nine months of 2006. The segment's results for the first nine months of 2006 include our share of earnings from Wachovia Securities, on a pre-tax basis, of \$202 million, compared to \$156 million in the first nine months of 2005 before transition costs. The segment's results also include expenses of \$228 million 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, compared to \$185 million in the first nine months of 2005. The current and prior year expenses reflect an increase in our reserve for settlement costs related to market timing issues involving Prudential Equity

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Group's former Prudential Securities operations, with respect to which the company announced that Prudential

Equity Group had reached a settlement in August, 2006. There are no transition costs in the first nine months of 2006 as the business integration was completed during the first half of 2005. Transition costs were \$20 million in the first nine months of 2005. In addition, results of the segment include adjusted operating income from our equity sales and trading operations of \$40 million in the first nine months of 2006, an increase of \$42 million from a loss of \$2 million in the first nine months of 2005. The increase came primarily from income of \$42 million from securities relating to trading exchange memberships, primarily representing shares received in connection with the commencement of public trading of exchange shares. The majority of those shares were transferred to our corporate operations during the first quarter of 2006. Subsequent to this transfer, changes in market value of the transferred shares are reflected within Corporate and Other results.

**Retirement****Operating Results**

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
	(in millions)			
<b>Operating results:</b>				
Revenues	\$ 1,112	\$ 1,047	\$ 3,215	\$ 3,002
Benefits and expenses	1,003	937	2,827	2,595
Adjusted operating income	109	110	388	407
Realized investment gains (losses), net, and related adjustments(1)	(57)	(31)	(141)	77
Related charges(2)	5	(1)	5	(5)
Investment gains (losses) on trading account assets supporting insurance liabilities, net(3)	238	(175)	(2)	(150)
Change in experience-rated contractholder liabilities due to asset value changes(4)	(149)	123	22	99
Income from continuing operations before income taxes	\$ 146	\$ 26	\$ 272	\$ 428

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



*Adjusted Operating Income*

*2006 to 2005 Three Month Comparison.* Adjusted operating income for the Retirement segment was essentially unchanged, amounting to \$110 million in the third quarter of 2005 and \$109 million in the third quarter of 2006. Mortgage prepayment income contributed \$15 million to results for third quarter of 2005, compared to a contribution of \$5 million for the current quarter. Largely offsetting the lower prepayment income was transition expenses related to the integration of the retirement business acquired from CIGNA, which

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amounted to \$11 million in the year-ago quarter while the current year quarter includes no transition expenses as the integration was completed in the first quarter of 2006.

*2006 to 2005 Nine Month Comparison.* Adjusted operating income for the Retirement segment decreased \$19 million, from \$407 million in the first nine months of 2005 to \$388 million in the first nine months of 2006. Results for the first nine months of 2006 include \$23 million from mortgage prepayment income, \$11 million from reserve releases reflecting updates of client census data on a group annuity block of business and \$6 million of transition expenses. Results for the first nine months of 2005 include \$45 million from mortgage prepayment income, \$28 million from reserve releases reflecting updates of client census data on a group annuity block of business, \$28 million of transition expenses and \$7 million from the collection of investment income on a previously defaulted bond.

Excluding the items discussed above, adjusted operating income increased \$5 million, from \$355 million in the first nine months of 2005 to \$360 million in the first nine months of 2006, reflecting higher investment results from a larger base of invested assets in our institutional investment products business, and increased fees due to higher full service retirement account balances primarily resulting from market appreciation. Offsetting these increases were higher crediting rates on full service general account liabilities and higher general and administrative expenses relating to the expansion of our full service distribution and client servicing capabilities.

*Revenues*

*2006 to 2005 Three Month Comparison.* Revenues, as shown in the table above under Operating Results, increased \$65 million, from \$1.047 billion in the third quarter of 2005 to \$1.112 billion in the third quarter of 2006. Net investment income increased \$97 million, of which \$25 million is due to the change in the arrangement related to the guaranteed cost business acquired from CIGNA. As a result of the conversion of the modified-coinsurance arrangement with CIGNA, discussed in Note 3 to the Unaudited Interim Consolidated Financial Statements, the results of the guaranteed cost business that were presented on a net basis in Asset management fees and other income prior to April 1, 2006, are now presented on a gross basis in our results of operations. The remainder of the increase in net investment income primarily reflects a larger base of invested assets due to sales of guaranteed investment products in the institutional and retail markets and investments financed by borrowings. In addition, net investment income in both periods reflects the benefit of mortgage prepayment income, which was \$10 million lower in the third quarter of 2006 as discussed above. Partially offsetting the increase in revenue discussed above was a decrease in premiums of \$22 million primarily as a result of lower sales of life-contingent structured settlements.

*2006 to 2005 Nine Month Comparison.* Revenues increased \$213 million, from \$3.002 billion in the first nine months of 2005 to \$3.215 billion in the first nine months of 2006. Net investment income increased \$271 million, of which \$51 million is due to the change in the arrangement related to the guaranteed cost business acquired from CIGNA as discussed above. The remainder of the increase in net investment income primarily reflects a larger base of invested assets due to sales of guaranteed investment products in the institutional and retail markets and investments financed by borrowings. As discussed above, net investment income in both periods reflects the benefit of mortgage prepayment income, which was \$22 million lower in the first nine months of 2006. In addition, net investment income in the first nine months of 2005 includes \$7 million from the collection of investment income on a previously defaulted bond. Partially offsetting the increases in revenue discussed above, was a decrease in premiums of \$44 million reflecting lower sales of life-contingent structured settlements in the current period, partially offset by a single large sale of a group annuity product in the first quarter of 2006.

*Benefits and Expenses*

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*2006 to 2005 Three Month Comparison.* Benefits and expenses, as shown in the table above under Operating Results, increased \$66 million, from \$937 million in the third quarter of 2005 to \$1.003 billion in the third quarter of 2006. Interest credited to policyholders' account balances increased \$44 million reflecting

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higher interest credited on the greater base of guaranteed investment products sold in the institutional and retail markets, as well as higher crediting rates on full service general account liabilities. Interest expense increased \$33 million primarily due to increased financing costs on increased borrowings, the proceeds of which were used to purchase invested assets. Policyholders' benefits, including the change in policy reserves, were relatively unchanged as the \$22 million decrease in premiums discussed above was offset by a \$22 million increase as a result of the change in the arrangement related to the guaranteed cost business acquired from CIGNA. General and administrative expenses were also relatively stable as the transition expenses in the year-ago quarter were mostly offset by expenses incurred in the current year quarter to expand our full service distribution and client servicing capabilities.

*2006 to 2005 Nine Month Comparison.* Benefits and expenses increased \$232 million, from \$2.595 billion in the first nine months of 2005 to \$2.827 billion in the first nine months of 2006. Interest credited to policyholders' account balances increased \$144 million reflecting higher interest credited on the greater base of guaranteed investment products sold in the institutional and retail markets, as well as higher crediting rates on full service general account liabilities. Interest expense increased \$86 million primarily due to increased financing costs on increased borrowings, the proceeds of which were used to purchase invested assets. Policyholders' benefits, including the change in policy reserves, increased \$18 million and reflects a \$44 million increase due to the change in the arrangement related to the guaranteed cost business acquired from CIGNA as discussed above and a \$17 million increase due to lower reserve releases in the current period as discussed above. Excluding these items, policyholders' benefits, including the change in policy reserves, decreased \$43 million, primarily from the \$44 million decrease in premiums discussed above. General and administrative expenses were relatively stable as the decrease in transition expenses in the current year period were mostly offset by expenses incurred to expand our full service distribution and client servicing capabilities.

*Sales Results and Account Values*

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
	(in millions)			
<b>Full Service(1):</b>				
Beginning total account value	\$ 91,537	\$ 85,331	\$ 88,385	\$ 83,891
Deposits and sales	2,914	3,509	12,433	9,960
Withdrawals and benefits	(3,272)	(3,202)	(12,155)	(9,388)
Change in market value, interest credited and interest income	2,185	2,699	4,701	3,874
Ending total account value	\$ 93,364	\$ 88,337	\$ 93,364	\$ 88,337
Net additions (withdrawals)	\$ (358)	\$ 307	\$ 278	\$ 572
<b>Institutional Investment Products(2):</b>				
Beginning total account value	\$ 46,913	\$ 48,612	\$ 48,080	\$ 47,680
Additions	2,004	802	4,628	3,280
Withdrawals and benefits	(711)	(896)	(4,592)	(3,299)
Change in market value, interest credited and interest income	995	311	1,600	1,757
Other(3)	267	88	(248)	(501)

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Ending total account value	\$ 49,468	\$ 48,917	\$ 49,468	\$ 48,917
Net additions (withdrawals)	\$ 1,293	\$ (94)	\$ 36	\$ (19)

(1) Ending total account value for the full service business includes assets of Prudential's retirement plan of \$5.5 billion and \$5.2 billion as of September 30, 2006 and 2005, respectively.

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- (2) Ending total account value for the institutional investment products business includes assets of Prudential's retirement plan of \$5.2 billion and \$7.2 billion as of September 30, 2006 and 2005, respectively.
- (3) Primarily represents changes in asset balances for externally managed accounts.

*2006 to 2005 Three Month Comparison.* Account values in our full service business amounted to \$93.4 billion as of September 30, 2006, an increase of \$1.827 billion from June 30, 2006. The increase in account values was driven by an increase in the market value of customer funds, partially offset by net withdrawals. Net additions (withdrawals) decreased \$665 million from net additions of \$307 million in the third quarter of 2005 to net withdrawals of \$358 million in the third quarter of 2006, as deposits for the prior year quarter included \$1.1 billion for existing defined benefit plans, reflecting a significant deposit by a single client, compared to \$336 million in the current quarter.

Account values in our institutional investment products business amounted to \$49.5 billion as of September 30, 2006, an increase of \$2.555 billion from June 30, 2006. The increase in account values was driven by net additions, as well as an increase in the market value of customer funds and interest on general account business. Net additions (withdrawals) increased \$1.387 billion from net withdrawals of \$94 million in the third quarter of 2005 to net additions of \$1.293 billion in the third quarter of 2006, reflecting higher sales of guaranteed investment products in the institutional and retail markets, primarily funding agreements through our Funding Agreements Notes Issuance Program.

*2006 to 2005 Nine Month Comparison.* Account values in our full service business amounted to \$93.4 billion as of September 30, 2006, an increase of \$4.979 billion from December 31, 2005. The increase in account values was driven principally by an increase in the market value of customer funds, together with the reinvestment of income. Account values in our full service business amounted to \$93.4 billion as of September 30, 2006, an increase of \$5.027 billion from September 30, 2005, primarily reflecting an increase in the market value of customer funds, together with the reinvestment of income, partially offset by net withdrawals. Net additions (withdrawals) decreased \$294 million, from net additions of \$572 million in the first nine months of 2005 to net additions of \$278 million in the first nine months of 2006, primarily reflecting an increase in participant withdrawals and the greater deposits in the prior year period for existing defined benefit plans, reflecting a significant deposit by a single client as discussed above. These items were partially offset by an increase in net plan sales, as new plan sales offset plan lapses.

Account values in our institutional investment products business amounted to \$49.5 billion as of September 30, 2006, an increase of \$1.388 billion from December 31, 2005, primarily reflecting interest on general account business and an increase in the market value of customer funds. Account values in our institutional investment products business amounted to \$49.5 billion as of September 30, 2006, an increase of \$551 million from September 30, 2005, primarily reflecting interest on general account business and an increase in the market value of customer funds, partially offset by net withdrawals. Net additions (withdrawals) were relatively unchanged in the first nine months of 2005 compared to first nine months of 2006, as higher sales of guaranteed investment products in the institutional and retail markets, were offset by transfers from the Retirement segment to our Asset Management segment. These transfers were approximately \$1.8 billion in the first nine months of 2006 compared to approximately \$0.4 billion in the first nine months of 2005.

**International Insurance and Investments Division**

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



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The financial results of our International Insurance segment and International Investments segment, excluding the global derivatives business, for all periods presented reflect the impact of an intercompany arrangement with Corporate and Other operations pursuant to which the segments non-U.S. dollar denominated earnings in all countries are translated at fixed currency exchange rates. The fixed rates are determined in connection with a currency hedging program designed to mitigate the risk that unfavorable exchange rate changes will reduce the segments U.S. dollar equivalent earnings. Pursuant to this program, Corporate and Other operations executes forward currency contracts with third parties to sell the hedged currency in exchange for U.S. dollars at a specified exchange rate. The maturities of these contracts correspond with the future periods in which the identified non-U.S. dollar denominated earnings are expected to be generated. This program is primarily associated with the International Insurance segment's businesses in Japan, Korea and Taiwan and the International Investments segment's businesses in Korea and Europe. The intercompany arrangement with Corporate and Other operations increased (decreased) revenues and adjusted operating income of each segment as follows for the periods indicated:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
	(in millions)			
Revenues and adjusted operating income:				
International Insurance	\$ 17	\$ (7)	\$ 32	\$ (43)
International Investments	(1)	(1)	(5)	(5)
<b>Total International Insurance and Investments Division</b>	<b>\$ 16</b>	<b>\$ (8)</b>	<b>\$ 27</b>	<b>\$ (48)</b>

Results of Corporate and Other operations include any differences between the translation adjustments recorded by the segments and the gains or losses recorded from the forward currency contracts. The net effect of this program within the Corporate and Other operations was a loss of \$4 million for the three months ended September 30, 2006 and no net gain or loss for the three months ended September 30, 2005, and losses of \$1 million and \$16 million for the nine months ended September 30, 2006 and 2005, respectively.

In addition, our Japanese insurance operations hold dual currency investments in the form of fixed maturities and loans. The principal of these dual currency investments are yen-denominated while the related interest income is U.S. dollar denominated. These investments are the economic equivalent of exchanging what would otherwise be fixed streams of yen-denominated interest income for fixed streams of U.S. dollars. Our Japanese insurance operations also hold investments in yen-denominated investments that have been coupled with cross-currency coupon swap agreements, creating synthetic dual currency investments. The yen/U.S. dollar exchange rate is effectively fixed, as we are obligated in future periods, to exchange fixed amounts of Japanese yen interest payments generated by the yen-denominated investments for U.S. dollars at the yen/U.S. dollar exchange rates specified by the cross-currency coupon swap agreements. The effect of these investments is taken into account as part of our currency hedging program. As of September 30, 2006 and December 31, 2005, the related principal of these investments were ¥548 billion, or \$4.9 billion and ¥222 billion, or \$1.9 billion, respectively. For the three months ended September 30, 2006 and 2005, the weighted average yield generated by these investments was 3.1% and 3.3%, respectively. For the nine months ended September 30, 2006 and 2005, the weighted average yield generated by these investments was 3.0% and 3.1%, respectively. For information regarding the weighted average exchange rate resulting from these investments see Dual Currency Investments, below.



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

	September 30, 2006	December 31, 2005
	(in millions)	
Forward currency contracts	\$ 98	\$ 110
Cross-currency coupon swap agreements	60	41
Foreign exchange component of interest on dual currency investments	14	19
<b>Total</b>	<b>\$ 172</b>	<b>\$ 170</b>

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

**International Insurance**

To provide a better understanding of operating performance within the International Insurance segment we have analyzed local results, where indicated below, both on the basis of weighted average monthly exchange rates, inclusive of the effects of the intercompany arrangement discussed above, and on the basis of constant exchange rates. When we discuss constant exchange rate information, it is on the basis of the average exchange rates for the year ended December 31, 2005.

**Operating Results**

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
	(in millions)			
<b>Operating Results:</b>				
Revenues:				
Life Planner operations	\$ 1,216	\$ 1,091	\$ 3,630	\$ 3,334
Gibraltar Life	708	863	2,177	2,448
	<b>1,924</b>	<b>1,954</b>	<b>5,807</b>	<b>5,782</b>

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<b>Benefits and expenses:</b>				
Life Planner operations	968	874	2,932	2,755
Gibraltar Life	559	722	1,816	2,057
	<u>1,527</u>	<u>1,596</u>	<u>4,748</u>	<u>4,812</u>
<b>Adjusted operating income:</b>				
Life Planner operations	248	217	698	579
Gibraltar Life	149	141	361	391
	<u>397</u>	<u>358</u>	<u>1,059</u>	<u>970</u>
Realized investment gains (losses), net, and related adjustments(1)	193	(5)	164	171
Related charges(2)	(13)	(1)	(4)	(87)
Investment gains (losses) on trading account assets supporting insurance liabilities, net(3)	19	76	(6)	109
Change in experience-rated contractholder liabilities due to asset value changes(4)	(19)	(76)	6	(109)
	<u>\$ 577</u>	<u>\$ 352</u>	<u>\$ 1,219</u>	<u>\$ 1,054</u>

- (1) Revenues exclude Realized investment gains (losses), net, and related charges and adjustments. The related charges represent the impact of Realized investment gains (losses), net, on the amortization of unearned

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

*Adjusted Operating Income*

*2006 to 2005 Three Month Comparison.* Adjusted operating income from our Life Planner operations increased \$31 million, from \$217 million in the third quarter of 2005 to \$248 million in third quarter of 2006, including a \$13 million favorable impact of currency fluctuations. Excluding the impact of currency fluctuations, adjusted operating income of our Life Planner operations increased \$18 million, primarily reflecting continued growth of our Japanese and Korean Life Planner operations and increased investment income margins. Adjusted operating income in the third quarter of 2005 included \$5 million from a reduction in our liability for guaranty fund assessments and a \$5 million benefit from reserve refinements on recently introduced products.

Gibraltar Life's adjusted operating income increased \$8 million, from \$141 million in the third quarter of 2005 to \$149 million in the third quarter of 2006, including a \$7 million favorable impact of currency fluctuations. Excluding the impact of currency fluctuations, adjusted operating income was essentially unchanged from the third quarter of 2005 to the third quarter of 2006. An increase in investment income margins of \$16 million, including current quarter income of \$6 million from a single real estate related investment, was essentially offset by a \$6 million charge in the current quarter from an increase in our liability for guaranty fund assessments for which the prior year quarter included a benefit of \$10 million.

*2006 to 2005 Nine Month Comparison.* Adjusted operating income from our Life Planner operations increased \$119 million, from \$579 million in the first nine months of 2005 to \$698 million in the first nine months of 2006, including a \$38 million favorable impact of currency fluctuations. Excluding the impact of currency fluctuations, adjusted operating income increased \$81 million reflecting continued growth of our Japanese and Korean Life Planner operations and improved investment margins. The improved investment margins reflect the favorable effect of certain investment portfolio strategies initially implemented in 2005 including increased investments in unhedged U.S. dollar denominated securities. Adjusted operating income in the first nine months of 2005 included \$5 million from a reduction in our liability for guaranty fund assessments and a \$5 million benefit from reserve refinements on recently introduced products.

Gibraltar Life's adjusted operating income declined \$30 million, from \$391 million in the first nine months of 2005 to \$361 million in the first nine months of 2006, including a \$16 million favorable impact of currency fluctuations. Refinements of certain policy liabilities resulted in a \$17 million reduction of Gibraltar Life's current period adjusted operating income, while results for the year-ago period benefited \$9 million from refinements in reserves for a block of business. Excluding the impact of these items and currency fluctuations, adjusted operating income of Gibraltar Life declined \$20 million. Adjusted operating income for the first nine months of 2006 includes a \$6 million charge for an increase in our estimated liability for guaranty fund assessments, for which the first nine months of 2005 included a benefit of \$10 million. In addition, mortality experience and expense levels were less favorable in the current year period. Improved investment income margins were a partial offset, reflecting the favorable effect of certain investment portfolio strategies initially implemented in 2005, including increased investments in unhedged U.S. dollar denominated securities, and income in the current year period of \$6 million from a single real estate related investment.

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**Table of Contents***Revenues*

*2006 to 2005 Three Month Comparison.* Revenues, as shown in the table above under Operating Results, declined \$30 million, from \$1.954 billion in the third quarter of 2005 to \$1.924 billion in the third quarter of 2006, including a net unfavorable impact of \$10 million relating to currency fluctuations. Excluding the impact of currency fluctuations, revenues declined \$20 million, from \$1.978 billion in the third quarter of 2005 to \$1.958 billion in the third quarter of 2006.

Revenues from our Life Planner operations, excluding the impact of currency fluctuations, increased \$122 million, from \$1.109 billion in the third quarter of 2005 to \$1.231 billion in the third quarter of 2006. This increase in revenues came primarily from increases in premiums and policy charges and fee income of \$85 million, from \$956 million in the third quarter of 2005 to \$1.041 billion in the third quarter of 2006, and an increase in net investment income of \$28 million, from \$147 million in the third quarter of 2005 to \$175 million in the third quarter of 2006, reflecting business growth and improved investment yields. Premiums and policy charges and fee income from our Japanese Life Planner operation increased \$61 million, from \$664 million in the third quarter of 2005 to \$725 million in the third quarter of 2006. Premiums and policy charges and fee income from our Korean operation increased \$20 million, from \$226 million in the third quarter of 2005 to \$246 million in the third quarter of 2006. The increase in premiums and policy charges and fee income in both operations was primarily the result of strong persistency.

Revenues for Gibraltar Life declined \$155 million, from \$863 million in the third quarter of 2005 to \$708 million in the third quarter of 2006, including a \$13 million unfavorable impact of currency fluctuations. Excluding the impact of the currency fluctuations, revenues decreased \$142 million, from \$869 million in the third quarter of 2005 to \$727 million in the third quarter of 2006. The decline in revenue reflects \$153 million in premiums recognized in the prior year quarter relating to additional face amounts of insurance issued pursuant to a special dividend arrangement established as part of Gibraltar Life's reorganization. Substantially all of the premiums recognized pursuant to the special dividend arrangement are offset by corresponding charges to increase reserves for the affected policies. A \$25 million increase in net investment income, from \$180 million in the third quarter of 2005 to \$205 million in the third quarter of 2006, partially offset the foregoing items. The increase in net investment income reflected the increase in Gibraltar Life's U.S. dollar denominated fixed annuity business, the favorable effect of certain investment portfolio strategies initially implemented in 2005, and current quarter income of \$6 million from a single real estate related investment as discussed above.

*2006 to 2005 Nine Month Comparison.* Revenues increased \$25 million, from \$5.782 billion in the first nine months of 2005 to \$5.807 billion in the first nine months of 2006, including a net unfavorable impact of \$200 million relating to currency fluctuations. Excluding the impact of currency fluctuations, revenues increased \$225 million, from \$5.709 billion in the first nine months of 2005 to \$5.934 billion in the first nine months of 2006.

Revenues from our Life Planner operations, excluding the impact of currency fluctuations, increased \$364 million, from \$3.314 billion in the first nine months of 2005 to \$3.678 billion in the first nine months of 2006. This increase in revenues came primarily from increases in premiums and policy charges and fee income of \$284 million, from \$2.875 billion in the first nine months of 2005 to \$3.159 billion in the first nine months of 2006 and a \$75 million increase in investment income from the first nine months of 2005 to the first nine months of 2006. Premiums and policy charges and fee income from our Japanese Life Planner operation increased \$198 million, from \$2.026 billion in the first nine months of 2005 to \$2.224 billion in the first nine months of 2006. Premiums and policy charges and fee income from our Korean operation increased \$76 million, from \$664 million in the first nine months of 2005 to \$740 million in the first nine months of 2006. The increase in premiums and policy charges and fee income in both operations was primarily the result of strong persistency. The increase in net investment income reflects business growth and the favorable effect of certain investment portfolio strategies initially implemented in 2005, as discussed above.

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Revenues for Gibraltar Life declined \$271 million, from \$2.448 billion in the first nine months of 2005 to \$2.177 billion in the first nine months of 2006, including a \$132 million unfavorable impact of currency

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fluctuations. Excluding the impact of the currency fluctuations, revenues declined \$139 million, from \$2.395 billion in the first nine months of 2005 to \$2.256 billion in the first nine months of 2006. The decline in revenues reflects a decline in premiums of \$199 million, from \$1.842 billion in the first nine months of 2005 to \$1.643 billion in the first nine months of 2006. The decline in premiums reflects a decrease of \$79 million in single premiums, as sales associated with retirement and savings objectives have transitioned from traditional products on which premiums are recorded to U.S. dollar denominated fixed annuities for which customer funds received are accounted for as deposits. In addition, premiums decreased \$64 million due to a decline in face amounts of insurance issued pursuant to the special dividend arrangement discussed above, which amounted to \$89 million in the first nine months of 2006 and \$153 million in the first nine months of 2005. A \$73 million increase in net investment income, from \$492 million in the first nine months of 2005 to \$565 million in the first nine months of 2006, was a partial offset. The increase in net investment income reflected the increase in Gibraltar Life's U.S. dollar denominated fixed annuity business, the favorable effect of certain investment portfolio strategies initially implemented in 2005, and current year period income of \$6 million from a single real estate related investment as discussed above.

*Benefits and Expenses*

*2006 to 2005 Three Month Comparison.* Benefits and expenses, as shown in the table above under Operating Results, declined \$69 million, from \$1.596 billion in the third quarter of 2005 to \$1.527 billion in the third quarter of 2006, including a favorable impact of \$30 million related to currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses declined \$39 million, from \$1.610 billion in the third quarter of 2005 to \$1.571 billion in the third quarter of 2006.

Benefits and expenses of our Life Planner operations, excluding the impact of currency fluctuations, increased \$104 million, from \$883 million in the third quarter of 2005 to \$987 million in the third quarter of 2006. On the same basis, benefits and expenses of our Japanese Life Planner operation increased \$65 million, from \$589 million in the third quarter of 2005 to \$654 million in the third quarter of 2006. Benefits and expenses from our Korean operation increased \$25 million, from \$204 million in the third quarter of 2005 to \$229 million in the third quarter of 2006. The increase in benefits and expenses in both operations reflects a greater volume of business in force, which was driven by new sales and strong persistency. Benefits and expenses in the third quarter of 2005 reflected favorable impacts of \$5 million from reduction in our liability for guaranty fund assessments in our Japanese Life Planner operation and \$5 million from reserve refinements on recently introduced products in our Korean operation.

Gibraltar Life's benefits and expenses declined \$163 million, from \$722 million in the third quarter of 2005 to \$559 million in the third quarter of 2006, including a \$20 million favorable impact of currency fluctuations. Excluding the impact of the currency fluctuations, benefits and expenses declined \$143 million, from \$727 million in the third quarter of 2005 to \$584 million in the third quarter of 2006, reflecting the increase in reserves recorded in the year-ago quarter corresponding to \$153 million of premiums recognized relating to the special dividend arrangement, discussed above. Benefits and expenses for the third quarter of 2006 include a \$6 million charge to increase our estimated liability for guaranty fund assessments, while the third quarter of 2005 included a favorable impact of \$10 million from reduction of that liability.

*2006 to 2005 Nine Month Comparison.* Benefits and expenses declined \$64 million, from \$4.812 billion in the first nine months of 2005 to \$4.748 billion in the first nine months of 2006, including a favorable impact of \$254 million related to currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased \$190 million, from \$4.715 billion in the first nine months of 2005 to \$4.905 billion in the first nine months of 2006.

Benefits and expenses of our Life Planner operations, excluding the impact of currency fluctuations, increased \$283 million, from \$2.710 billion in the first nine months of 2005 to \$2.993 billion in the first nine months of 2006. On the same basis, benefits and expenses of our Japanese Life Planner operation increased \$190



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million, from \$1.850 billion in the first nine months of 2005 to \$2.040 billion in the first nine months of 2006. Benefits and expenses from our Korean operation increased \$69 million, from \$599 million in the first nine months of 2005 to \$668 million in the first nine months of 2006. The increase in benefits and expenses in both operations reflects a greater volume of business in force, which was driven by new sales and strong persistency. Benefits and expenses in the first nine months of 2005 include the favorable impacts of reduction in our liability for guaranty fund assessments in our Japanese Life Planner operation and reserve refinements on recently introduced products in our Korean operation described above.

Gibraltar Life's benefits and expenses declined \$241 million, from \$2.057 billion in the first nine months of 2005 to \$1.816 billion in the first nine months of 2006, including a \$148 million favorable impact of currency fluctuations. Excluding the impact of the currency fluctuations, benefits and expenses declined \$93 million, from \$2.005 billion in the first nine months of 2005 to \$1.912 billion in the first nine months of 2006, reflecting the lower increases in reserves due to \$64 million lower premiums associated with the special dividend arrangement and lower single premiums as discussed above. These lower reserve increases corresponding to the level of premiums were partially offset by a less favorable level of policyholder benefits and expenses, which included charges of \$17 million in the first nine months of 2006 from refinements in policy liabilities, compared to a favorable impact of \$9 million in the prior year period from refinements in reserves for a block of business. Additionally, benefits and expenses for the first nine months of 2006 include a \$6 million charge to increase our estimated liability for guaranty fund assessments, while the first nine months of 2005 included a favorable impact of \$10 million from reduction of that liability.

*Sales Results*

In managing our international insurance business, we analyze new annualized premiums, which do not correspond to revenues under U.S. GAAP, as well as revenues, because new annualized premiums measure the current sales performance of the segment, while revenues reflect the renewal persistency and aging of in force policies written in prior years and net investment income, in addition to current sales. New annualized premiums on an actual and constant exchange rate basis are as follows for the periods indicated.

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	(in millions)			
<b>New annualized premiums:</b>				
On an actual exchange rate basis(1):				
Life Planner operations	\$ 174	\$ 181	\$ 575	\$ 665
Gibraltar Life	91	82	279	249
<b>Total</b>	<b>\$ 265</b>	<b>\$ 263</b>	<b>\$ 854</b>	<b>\$ 914</b>
On a constant exchange rate basis(2):				
Life Planner operations	\$ 176	\$ 182	\$ 580	\$ 659
Gibraltar Life	93	82	287	242
<b>Total</b>	<b>\$ 269</b>	<b>\$ 264</b>	<b>\$ 867</b>	<b>\$ 901</b>

- (1) Amounts for Gibraltar Life and total new annualized premiums on an actual exchange rate basis for the nine months ended September 30, 2006 reflect changes in the previously reported amounts of those items for the three months ended June 30, 2006 from \$134 million and



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- \$319 million to \$115 million and \$300 million, respectively, and for the six months ended June 30, 2006 from \$207 million and \$608 million to \$188 million and \$589 million, respectively, revising second quarter fixed annuity production of Life Advisors.
- (2) Amounts for Gibraltar Life and total new annualized premiums on a constant exchange rate basis for the nine months ended September 30, 2006 reflect changes in the previously reported amounts of those items for the three months ended June 30, 2006 from \$137 million and \$322 million to \$118 million and \$303

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million, respectively, and for the six months ended June 30, 2006 from \$213 million and \$617 million to \$194 million and \$598 million, respectively, revising second quarter fixed annuity production of Life Advisors.

*2006 to 2005 Three Month Comparison.* On a constant exchange rate basis, new annualized premiums increased \$5 million, from \$264 million in the third quarter of 2005 to \$269 million in the third quarter of 2006. On the same basis, new annualized premiums from our Japanese Life Planner operation were unchanged from the third quarter of 2005, reflecting a decline in sales of U.S. dollar denominated whole life products resulting from higher sales in the prior year quarter in anticipation of a reduction in guaranteed crediting rates in the fourth quarter of 2005 offset by an increase in sales of term life insurance products. Sales in all other countries, also on a constant exchange rate basis, declined \$6 million from the third quarter of 2005 to the third quarter of 2006 reflecting primarily declines in sales of our variable annuity product in Korea. New annualized premiums from our Gibraltar Life operation increased \$11 million, on a constant exchange rate basis, from the third quarter of 2005 to the third quarter of 2006 primarily due to sales of the U.S. dollar denominated single premium fixed annuity, a product launched in April 2005, contributing approximately \$20 million more in the current quarter primarily due to sales through our bank distribution channel which commenced in March 2006, and sales of our U.S. denominated whole life policies, introduced in October 2005, which contributed \$5 million to current period results. Sales of single pay whole life products declined \$6 million, from \$8 million in the third quarter of 2005 to \$2 million in the third quarter of 2006. Sales of all other products declined \$8 million from the third quarter of 2005.

*2006 to 2005 Nine Month Comparison.* On a constant exchange rate basis, new annualized premiums declined \$34 million, from \$901 million in the first nine months of 2005 to \$867 million in the first nine months of 2006. On the same basis, new annualized premiums from our Japanese Life Planner operation declined \$82 million, reflecting a decline in sales of U.S. dollar denominated retirement income and whole life products resulting from strong sales in the prior year period in anticipation of a reduction in guaranteed crediting rates in 2005 partially offset by increases in sales of term life insurance products. Sales in all other countries, also on a constant exchange rate basis, increased \$3 million reflecting primarily increases in sales of our variable life product in Taiwan. New annualized premiums from our Gibraltar Life operation increased \$45 million, on a constant exchange rate basis, from the first nine months of 2005 to the first nine months of 2006 primarily due to sales of the U.S. dollar denominated single premium fixed annuity contributing \$89 million more in the current period, including \$39 million of sales through our bank distribution channel and sales of our U.S. dollar denominated whole life policies which contributed \$18 million to current period results, as discussed above. Sales of single pay whole life products declined \$34 million, from \$44 million in the first nine months of 2005 to \$10 million in the first nine months of 2006. Sales of all other products declined \$28 million from the first nine months of 2005.

*Investment Margins and Other Profitability Factors*

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

We base premiums and cash values in most countries in which we operate on mandated mortality and morbidity tables. Our mortality and morbidity experience in the International Insurance segment on an overall basis in the first nine months of 2006 and the first nine months of 2005 was well within our pricing assumptions and below the guaranteed levels reflected in the premiums we charge.

**Table of Contents***Dual Currency Investments*

The table below presents as of September 30, 2006, the yen-denominated earnings subject to our dual currency and synthetic dual currency investments and the related weighted average exchange rates resulting from these investments.

Year	(1)		Cross-currency coupon swap element of synthetic dual currency investments	Yen-denominated earnings subject to these investments	Weighted average exchange rate per U.S. Dollar
	Interest component of dual currency investments				
			(in billions)		(Yen per \$)
Remainder of 2006	¥ 1.0	¥ 1.7		¥ 2.7	91.0
2007	3.6	6.7		10.3	90.7
2008	3.5	6.5		10.0	90.3
2009	3.4	5.9		9.3	89.1
2010-2034	42.3	65.8		108.1	80.4
Total	¥ 53.8	¥ 86.6		¥ 140.4	82.4

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

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

*International Investments**Operating Results*

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
	(in millions)			
<b>Operating results:</b>				
Revenues	\$ 132	\$ 122	\$ 428	\$ 356

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Expenses	101	97	319	287
Adjusted operating income	31	25	109	69
Realized investment gains (losses), net, and related adjustments(1)		3	1	
Related charges(2)		(1)		
Income from continuing operations before income taxes	\$ 31	\$ 27	\$ 110	\$ 69

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

*Adjusted Operating Income*

*2006 to 2005 Three Month Comparison.* Adjusted operating income increased \$6 million, from \$25 million in the third quarter of 2005 to \$31 million in the third quarter of 2006. This increase was primarily attributable to improved sales and trading results from our global derivatives business, partially offset by less favorable results

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from the segment's Korean asset management operations. Adjusted operating income from our Korean asset management operations includes \$6 million and \$5 million, respectively, of fee revenue from the Korean government under an agreement entered into in connection with the acquisition in 2004 of Prudential Investment & Securities Co., Ltd., or PISC, related to the provision of asset management and brokerage services, which agreement extends until February 27, 2009.

*2006 to 2005 Nine Month Comparison.* Adjusted operating income increased \$40 million, from \$69 million in the first nine months of 2005 to \$109 million in the first nine months of 2006. This increase includes \$16 million of income recognized in the current year period representing market value changes on securities held relating to trading exchange memberships. More favorable sales and trading results from our global derivatives business, as well as improved results from the segment's asset management operations reflecting higher performance fees and asset management fees in a joint venture, also contributed to the increase in adjusted operating income. Adjusted operating income from our Korean asset management operations includes \$18 million and \$16 million, respectively, of fee revenue from the Korean government under the agreement discussed above.

### *Revenues*

*2006 to 2005 Three Month Comparison.* Revenues, as shown in the table above under Operating Results, increased \$10 million, from \$122 million in the third quarter of 2005 to \$132 million in the third quarter of 2006, primarily as a result of higher revenues from our global derivatives business as discussed above.

*2006 to 2005 Nine Month Comparison.* Revenues increased \$72 million, from \$356 million in the first nine months of 2005 to \$428 million in the first nine months of 2006. This increase includes \$16 million of income recognized in the current year period representing market value changes on securities held relating to trading exchange memberships. Also contributing to this increase was higher revenues from our global derivatives business, our Korean asset management operations and a joint venture as discussed above.

### *Expenses*

*2006 to 2005 Three Month Comparison.* Expenses, as shown in the table above under Operating Results, increased \$4 million, from \$97 million in the third quarter of 2005 to \$101 million in the third quarter of 2006, primarily due to higher expenses corresponding with the higher level of revenues generated by our global derivatives business.

*2006 to 2005 Nine Month Comparison.* Expenses increased \$32 million, from \$287 million in the first nine months of 2005 to \$319 million in the first nine months of 2006, primarily due to higher expenses corresponding with the higher level of revenues generated by our global derivatives business and our Korean asset management operations.

**Table of Contents****Corporate and Other**

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

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
	(in millions)			
<b>Operating Results:</b>				
Corporate Operations(1)	\$ (21)	\$ 7	\$ 3	\$ 41
Real Estate and Relocation Services	36	43	75	85
Adjusted operating income	15	50	78	126
Realized investment gains (losses), net, and related adjustments(2)	119	77	56	307
Divested businesses(3)	4	(1)	13	(5)
Income from continuing operations before income taxes	\$ 138	\$ 126	\$ 147	\$ 428

(1) Includes consolidating adjustments.

(2) See Realized Investment Gains and General Account Investments Realized Investment Gains.

(3) See Divested Businesses for a discussion of the results of our divested businesses.

*2006 to 2005 Three Month Comparison.* Adjusted operating income decreased \$35 million, from \$50 million in the third quarter of 2005 to \$15 million in the third quarter of 2006. Adjusted operating income from corporate operations decreased \$28 million, from income of \$7 million in the third quarter of 2005 to a loss of \$21 million in the third quarter of 2006. Corporate operations investment income, net of interest expense, decreased \$34 million primarily reflecting the impact of deployment of our excess capital in our businesses and for share repurchases, higher short term borrowing rates, and less favorable joint venture results in the current quarter. These items were offset by income from the investment of proceeds from our issuance of \$2 billion principal amount of convertible debt securities in November 2005. General and administrative expenses, excluding income from our qualified pension plan, declined by \$31 million. Corporate operations includes income from our qualified pension plan of \$86 million in the third quarter of 2006, a decrease of \$17 million from \$103 million in the third quarter of 2005. The decline includes the impact of a reduction in the expected return on plan assets from 8.5% for 2005 to 8.0% for 2006.

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Adjusted operating income of our real estate and relocation services business decreased \$7 million, from \$43 million in the third quarter of 2005 to \$36 million in the third quarter of 2006. The decline is driven by less favorable residential real estate market conditions in the current quarter.

*2006 to 2005 Nine Month Comparison.* Adjusted operating income decreased \$48 million, from \$126 million in the first nine months of 2005 to \$78 million in the first nine months of 2006. Adjusted operating income from corporate operations decreased \$38 million, from \$41 million in the first nine months of 2005 to \$3 million in the first nine months of 2006. Corporate operations investment income, net of interest expense, decreased \$50 million primarily reflecting the impact of deployment of our excess capital in our businesses and for share repurchases, and higher short term borrowing rates. These items were offset by income from the

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investment of proceeds from our issuance of \$2 billion principal amount of convertible debt securities in November 2005, as well as more favorable results from our joint venture investments. General and administrative expenses, excluding income from our qualified pension plan, declined by \$62 million. Corporate operations includes income from our qualified pension plan of \$258 million in the first nine months of 2006, a decrease of \$51 million from \$309 million in the first nine months of 2005. The decline includes the impact of a reduction in the expected return on plan assets from 8.5% for 2005 to 8.0% for 2006.

Adjusted operating income of our real estate and relocation services business decreased \$10 million, from \$85 million in the first nine months of 2005 to \$75 million in the first nine months of 2006. The decline was driven by less favorable residential real estate market conditions in the current period.

### **Results of Operations of Closed Block Business**

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

At the end of each year, the Board of Directors of Prudential Insurance determines the dividends payable on participating policies for the following year based on the experience of the Closed Block, including investment income, net realized and unrealized investment gains, mortality experience and other factors. Although Closed Block experience for dividend action decisions is based upon statutory results, at the time the Closed Block was established, we developed, as required by U.S. GAAP, an actuarial calculation of the timing of the maximum future earnings from the policies included in the Closed Block. If actual cumulative earnings in any given period are greater than the cumulative earnings we expected, we will record this excess as a policyholder dividend obligation. We will subsequently pay this excess to Closed Block policyholders as an additional dividend unless it is otherwise offset by future Closed Block performance that is less favorable than we originally expected. The policyholder dividends we charge to expense within the Closed Block Business will include any change in policyholder dividend obligations that we recognize for the excess of actual cumulative earnings in any given period over the cumulative earnings we expected in addition to the actual policyholder dividends declared by the Board of Directors of Prudential Insurance.

As of September 30, 2006, the Company has recognized a policyholder dividend obligation to Closed Block policyholders for the excess of actual cumulative earnings over the expected cumulative earnings of \$360 million. Actual cumulative earnings, as required by U.S. GAAP, reflect the recognition of realized investment gains in the current period, as well as changes in assets and related liabilities that support the policies. Additionally, net unrealized investment gains have arisen subsequent to the establishment of the Closed Block due to the impact of lower interest rates on the market value of fixed maturities available for sale. These net unrealized investment gains have been reflected as a policyholder dividend obligation of \$1.809 billion as of 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.



**Table of Contents***Operating Results*

Management does not consider adjusted operating income to assess the operating performance of the Closed Block Business. Consequently, results of the Closed Block Business for all periods are presented only in accordance with U.S. GAAP. The following table sets forth the Closed Block Business U.S. GAAP results for the periods indicated.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
	(in millions)			
<b>GAAP results:</b>				
Revenues	\$ 1,889	\$ 1,865	\$ 5,589	\$ 5,963
Benefits and expenses	1,815	1,804	5,393	5,459
Income from continuing operations before income taxes	\$ 74	\$ 61	\$ 196	\$ 504

*Income from Continuing Operations Before Income Taxes*

*2006 to 2005 Three Month Comparison.* Income from continuing operations before income taxes increased \$13 million, from \$61 million in the third quarter of 2005 to \$74 million in the third quarter of 2006. Current quarter results reflect net realized investment gains of \$150 million as compared to \$97 million in the third quarter of 2005, an increase of \$53 million. For a discussion of Closed Block Business realized investment gains (losses), net, see Realized Investment Gains and General Account Investments Realized Investment Gains. The increase in net realized investment gains was partially offset by an increase in dividends to policyholders of \$31 million, which includes an increase to the cumulative earnings policyholder dividend obligation of \$22 million from the third quarter of 2005 to the third quarter of 2006, as the prior year benefited from a reduction in the 2005 dividend scale.

*2006 to 2005 Nine Month Comparison.* Income from continuing operations before income taxes decreased \$308 million, from \$504 million in the first nine months of 2005 to \$196 million in the first nine months of 2006. Current period results reflect net realized investment gains of \$182 million as compared to \$510 million in the prior year period, a decrease of \$328 million. For a discussion of Closed Block Business realized investment gains (losses), net, see Realized Investment Gains and General Account Investments Realized Investment Gains. The decrease in net realized investment gains was partially offset by a decrease in dividends to policyholders of \$53 million, which includes a decrease to the cumulative earnings policyholder dividend obligation of \$88 million from the first nine months of 2005 to the first nine months of 2006.

*Revenues*

*2006 to 2005 Three Month Comparison.* Revenues, as shown in the table above under Operating Results, increased \$24 million, from \$1.865 billion in the third quarter of 2005 to \$1.889 billion in the third quarter of 2006. Revenues in the current quarter reflect a \$53 million increase in net realized investment gains, partially offset by a decrease of \$17 million in net investment income due to a decline in the level of invested

assets.

*2006 to 2005 Nine Month Comparison.* Revenues decreased \$374 million, from \$5.963 billion in the first nine months of 2005 to \$5.589 billion in the first nine months of 2006, principally driven by the \$328 million decrease in net realized investment gains.

*Benefits and Expenses*

*2006 to 2005 Three Month Comparison.* Benefits and expenses, as shown in the table above under Operating Results, increased \$11 million, from \$1.804 billion in the third quarter of 2005 to \$1.815 billion in the third quarter of 2006, as dividends to policyholders increased \$31 million, reflecting an increase to the cumulative earnings policyholder dividend obligation of \$22 million from the third quarter of 2005 to the third quarter of 2006.

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*2006 to 2005 Nine Month Comparison.* Benefits and expenses decreased \$66 million, from \$5.459 billion in the first nine months of 2005 to \$5.393 billion in the first nine months of 2006, as dividends to policyholders decreased \$53 million, primarily reflecting a decrease to the cumulative earnings policyholder dividend obligation of \$88 million from the first nine months of 2005 to the first nine months of 2006.

**Income Taxes**

Our income tax expense amounted to \$411 million in the third quarter of 2006 compared to a benefit of \$261 million in the third quarter of 2005. The benefit in the prior period includes a favorable adjustment of \$720 million reflecting the resolution of substantially all issues relating to the Internal Revenue Service examination of our consolidated federal income tax returns for the 1997 to 2001 periods. Our income tax provision, excluding this benefit, represented 41% of income from continuing operations before income taxes in the third quarter of 2005 and 27% in the third quarter of 2006. The higher effective tax rate in the 2005 period primarily reflects an increase in income tax expense for a change in assumptions regarding the repatriation of earnings from our Canadian operations as discussed below. The lower effective tax rate in the third quarter of 2006 primarily reflects an increase in the dividends received deduction.

Our income tax provision amounted to \$908 million in the first nine months of 2006 compared to \$520 million in the first nine months of 2005. The tax provision for the first nine months of 2005 includes a favorable adjustment of \$720 million, as discussed above. Our income tax provision, excluding this benefit, represented 33% of income from continuing operations before income taxes in the first nine months of 2005 and 28% in the first nine months of 2006. The higher effective tax rate in the 2005 period primarily reflects an increase in income tax expense for a change in assumptions regarding the repatriation of earnings from our Canadian operations as discussed below. The lower effective tax rate in the first nine months of 2006 primarily reflects an increase in the dividends received deduction.

Beginning with the third quarter of 2005, we adopted a policy that historical earnings of our Canadian operations will be available for repatriation to the U.S. This change resulted in an increase in income tax expense of \$83 million in the third quarter of 2005 and, accordingly, an increase in our effective tax rate for the quarter and nine-month periods.

The Company employs various tax strategies, including strategies to minimize the amount of taxes resulting from realized capital gains.

**Discontinued Operations**

Included within net income are the results of businesses which are reflected as discontinued operations under U.S. GAAP. A summary of the results of discontinued operations by business is as follows for the periods indicated:

<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
<b>September 30,</b>		<b>September 30,</b>	
<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
(in millions)			

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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
	<u>        </u>	<u>        </u>	<u>        </u>	<u>        </u>
Income (loss) from discontinued operations before income taxes	100	(18)	70	(59)
Income tax expense (benefit)	32	(3)	24	(6)
	<u>        </u>	<u>        </u>	<u>        </u>	<u>        </u>
Income (loss) from discontinued operations, net of taxes	\$ 68	\$ (15)	\$ 46	\$ (53)
	<u>        </u>	<u>        </u>	<u>        </u>	<u>        </u>

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

### **Realized Investment Gains and General Account Investments**

#### **Realized Investment Gains**

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

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

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

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

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

We use interest and currency swaps and other derivatives to manage interest and currency exchange rate exposures arising from mismatches between assets and liabilities, including duration mismatches. We also use derivative contracts to mitigate the risk that unfavorable changes in

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currency exchange rates will reduce U.S. dollar equivalent earnings generated by certain of our non-U.S. businesses. Derivative contracts also include forward purchases and sales of to-be-announced mortgage-backed securities primarily related to our mortgage dollar roll program. Many of these derivative contracts do not qualify for hedge accounting, and, consequently,

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we recognize the changes in fair value of such contracts from period to period in current earnings, although we do not necessarily account for the related assets or liabilities the same way. Accordingly, realized investment gains and losses from our derivative activities can contribute significantly to fluctuations in net income.

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

The following tables set forth Realized investment gains (losses), net, by investment type for the Financial Services Businesses and Closed Block Business, as well as related charges and adjustments associated with the Financial Services Businesses, for the three and nine months ended September 30, 2006 and 2005, respectively. For a discussion of our general account investment portfolio and related results, including overall income yield and investment income, as well as our policies regarding other than temporary declines in investment value and the related methodology for recording impairment charges, see General Account Investments below. For additional details regarding adjusted operating income, which is our measure of performance for the segments of our Financial Services Businesses, see Note 9 to the Unaudited Interim Consolidated Financial Statements.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
(in millions)				
<b>Realized investment gains (losses), net:</b>				
Financial Services Businesses	\$ 239	\$ 133	\$ 64	\$ 713
Closed Block Business	150	97	182	510
Consolidated realized investment gains (losses), net	\$ 389	\$ 230	\$ 246	\$ 1,223
<b>Financial Services Businesses:</b>				
Realized investment gains (losses), net				
Fixed maturity investments	\$ (4)	\$ 44	\$ (314)	\$ 73
Equity securities	12	41	120	84
Derivative instruments	126	42	72	338
Other	105	6	186	218
Total	239	133	64	713
Related adjustments(1)	(25)	(44)	(134)	(46)
Realized investment gains (losses), net, and related adjustments	\$ 214	\$ 89	\$ (70)	\$ 667
Related charges(1)	\$ 7	\$ (10)	\$ 30	\$ (104)
<b>Closed Block Business:</b>				
Realized investment gains (losses), net				
Fixed maturity investments	\$ 33	\$ 56	\$ 1	\$ 261
Equity securities	23	70	151	206

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Derivative instruments	79	(26)	(41)	39
Other	15	(3)	71	4
	<u>        </u>	<u>        </u>	<u>        </u>	<u>        </u>
Total	\$ 150	\$ 97	\$ 182	\$ 510
	<u>        </u>	<u>        </u>	<u>        </u>	<u>        </u>

(1) See Note 9 to the Unaudited Interim Consolidated Financial Statements for a further explanation of these items.



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**Table of Contents*****2006 to 2005 Three Month Comparison****Financial Services Businesses*

The Financial Services Businesses' net realized investment gains in the third quarter of 2006 were \$239 million, compared to net realized investment gains of \$133 million in the third quarter of 2005. Net realized losses on fixed maturity securities were \$4 million in the third quarter of 2006 and reflect net losses on sales and maturities of fixed maturity securities of \$2 million, including gross losses of \$63 million, which were primarily interest-rate related. Interest-rate related losses on fixed maturity securities reflect sales of lower yielding bonds in a higher rate environment in order to meet various cash flow needs, manage portfolio duration and reflect our strategy for minimizing the amount of taxes on realized capital gains. Interest-rate related losses, which are excluded from adjusted operating income, where the proceeds from the sale of the securities are reinvested will generally result in higher net investment income to be included in adjusted operating income in future periods. See

General Account Investments' Investment Results for a discussion of current period yields of the Financial Services Businesses. Fixed maturity net realized losses also included fixed maturity impairments of \$5 million and credit losses of \$5 million in the third quarter of 2006, partially offset by private bond prepayment premiums of \$8 million. Net realized gains on fixed maturity securities were \$44 million in the third quarter of 2005 and reflect net gains on sales and maturities of fixed maturity securities of \$34 million, including gross losses of \$30 million, which were primarily interest-rate related. Net realized gains on fixed maturity securities also include private bond prepayment premiums of \$32 million, partially offset by impairments and credit losses of \$15 million and \$7 million, respectively. Realized net gains on equity securities were \$12 million in the third quarter of 2006, compared with realized net gains on equity securities in the third quarter of 2005 of \$41 million, primarily due to sales in our Gibraltar Life operation. Realized gains in the third quarter of 2006 included net derivative gains of \$126 million, compared to net derivative gains of \$42 million in the third quarter of 2005. The derivative gains in the third quarter of 2006 were primarily the result of net gains of \$81 million from positive mark-to-market adjustments on foreign currency forward contracts used to hedge the future income of non-U.S. businesses, mainly driven by the strengthening of the U.S. dollar against the Japanese yen. Net derivative gains also include \$37 million on currency swaps used in conjunction with fixed maturity investments and net gains of \$34 million on Japanese yen interest rate derivatives used to manage the duration of the Japanese fixed maturity investment portfolio as yen long-term interest rates declined. Offsetting these gains were net losses on U.S. Treasury futures positions used to manage the duration of the fixed maturity investment portfolio. The derivative gains in the third quarter of 2005 were primarily the result of positive mark-to-market adjustments of \$52 million on foreign currency forward contracts used to hedge the future income of non-U.S. businesses, driven by the strengthening of the U.S. dollar. Offsetting these gains were net losses on swaps used to manage the duration of the fixed maturity investment portfolio. Net realized investment gains on other investments were \$105 million in the third quarter of 2006, which were primarily related to net gains from real estate related investments and loan securitizations.

During the third quarter of 2006, we recorded total other than temporary impairments of \$7 million attributable to the Financial Services Businesses, compared to total other than temporary impairments of \$17 million attributable to the Financial Services Businesses in the third quarter of 2005. The impairments in the third quarter of 2006 consisted of \$5 million relating to fixed maturities and \$2 million relating to equity securities. The impairments in the third quarter of 2005 consisted of \$15 million relating to fixed maturities and \$2 million relating to other invested assets which include primarily commercial loans and investments in joint ventures and partnerships.

The impairments recorded on fixed maturities in the third quarter of 2006 consist of \$1 million on public securities and \$4 million on private securities, compared with fixed maturity impairments of \$13 million on public securities and \$2 million on private securities in the third quarter of 2005. Impairments in the third quarter of 2006 were concentrated in the retail and wholesale and manufacturing sectors and in the third quarter of 2005 were concentrated in the manufacturing sector and were primarily driven by downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers.

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**Table of Contents***Closed Block Business*

For the Closed Block Business, net realized investment gains in the third quarter of 2006 were \$150 million, compared to net realized investment gains of \$97 million in the third quarter of 2005. Realized gains on fixed maturity securities were \$33 million in the third quarter of 2006 and reflect net gains on sales and maturities of fixed maturity securities of \$39 million, and private bond prepayment premiums of \$12 million, partially offset by impairments of \$12 million and credit losses of \$6 million in the third quarter of 2006. Net realized gains on fixed maturity securities were \$56 million in the third quarter of 2005 and reflect net gains on sales and maturities of fixed maturity securities of \$38 million and private bond prepayment premiums of \$31 million, partially offset by impairments and credit losses of \$10 million and \$3 million, respectively. We realized net gains on equity securities of \$23 million in third quarter of 2006, compared to net gains of \$70 million in third quarter of 2005. The net realized gains on equity securities in the third quarter of 2006 and 2005 were primarily the result of sales pursuant to our active management strategy. Net gains on derivatives were \$79 million in the third quarter of 2006, compared to net losses of \$26 million in the third quarter of 2005. Derivative gains in the third quarter of 2006 were primarily the result of net gains of \$64 million on interest rate derivatives used to manage the duration of the fixed maturity investment portfolio. The derivative losses in the third quarter of 2005 were primarily related to net losses on interest rate derivatives used to manage the duration of the fixed maturity portfolio.

During the third quarter of 2006, we recorded total other than temporary impairments of \$13 million attributable to the Closed Block Business, compared to total other than temporary impairments of \$12 million attributable to the Closed Block Business in the third quarter of 2005. The impairments in the third quarter of 2006 consisted of \$12 million relating to fixed maturities and \$1 million relating to equity securities. The impairments in the third quarter of 2005 consisted of \$10 million relating to fixed maturities, \$1 million relating to equity securities and \$1 million related to other invested assets as defined above.

The impairments recorded on fixed maturities in the third quarter of 2006 consist of \$3 million on public securities and \$9 million on private securities, compared with \$6 million on public securities and \$4 million on private securities in the third quarter of 2005. Impairments in both the third quarter of 2006 and 2005 were concentrated in the services and retail and wholesale sectors and were primarily driven by downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers. Included in private fixed maturity impairments for 2006 were impairments relating to a national dry cleaning operation. Included in private fixed maturity impairments for the third quarter of 2005 were impairments relating to an electronic test equipment distributor.

***2006 to 2005 Nine Month Comparison****Financial Services Businesses*

The Financial Services Businesses net realized investment gains in the first nine months of 2006 were \$64 million, compared to net realized investment gains of \$713 million in the first nine months of 2005. Net realized losses on fixed maturity securities were \$314 million in the first nine months of 2006 and reflect net losses on sales and maturities of fixed maturity securities of \$308 million, impairments of \$21 million and credit losses of \$13 million, partially offset by private bond prepayment premiums of \$28 million. Net realized losses on fixed maturity securities include gross losses of \$472 million, which were primarily interest-rate related. Interest-rate related losses on fixed maturities reflect sales of lower yielding bonds in a higher rate environment in order to meet various cash flow needs, manage portfolio duration and reflect our strategy for minimizing the amount of taxes on realized capital gains. Interest-rate related losses, which are excluded from adjusted operating income, where the proceeds from the sale of the securities are reinvested will generally result in higher net investment income to be included in adjusted operating income in future periods. See General Account Investments Investment Results for a discussion of current period yields of the Financial Services Businesses. Net realized gains on fixed maturity securities were \$73 million in the first nine months of 2005 and relate primarily to private bond prepayment premiums of \$80 million, a \$33 million recovery of impaired principal on a previously



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defaulted bond and net gains on sales of fixed maturity securities of \$10 million, including gross losses of \$233

million, partially offset by impairments of \$23 million and credit-related losses of \$27 million. Realized net gains on equity securities were \$120 million in the first nine months of 2006, compared to net realized gains of \$84 million in the first nine months of 2005, primarily due to sales in our Gibraltar Life operation. Net realized gains on equity securities in the first nine months of 2005 also include gains due to sales in our proprietary investing business. Realized gains in the first nine months of 2006 include net derivative gains of \$72 million, compared to net derivative gains of \$338 million in the first nine months of 2005. The derivative gains in the first nine months of 2006 were primarily the result of net gains of \$47 million from interest rate swap contracts mainly used to manage the duration of the U.S. dollar fixed maturity investment portfolio as interest rates rose and net gains of \$21 million on currency swaps used in conjunction with fixed maturity investments. Net derivative gains also include net gains of \$14 million from positive mark-to-market adjustments on foreign currency forward contracts used to hedge the future income of non-U.S. businesses, mainly driven by the strengthening of the U.S. dollar against the Japanese yen. The gains in the first nine months of 2005 were primarily the result of positive mark-to-market adjustments of \$227 million on currency forward contracts used to hedge the future income of non-U.S. businesses, driven by the strengthening of the U.S. dollar. In addition, derivative net gains resulted from currency and interest rate swaps used to manage currency and interest rate risks. Net realized investment gains on other investments were \$186 million in the first nine months of 2006, which were primarily related to net gains from real estate related investments and loan securitizations. Net realized investment gains on other investments were \$218 million in the first nine months of 2005, which included a \$110 million net gain for a Gibraltar Life settlement with Dai Ichi Fire and Marine Insurance Company related to certain capital investments made by Gibraltar Life's predecessor, Kyoei Life Insurance Company Ltd., in Dai Ichi. This amount was partially offset in our Statement of Operations by a \$68 million increase in Dividends to policyholders in accordance with the reorganization plan entered into at the time of the Company's acquisition of Gibraltar Life, which is reflected as a related charge. Both of these items are excluded from adjusted operating income.

During the first nine months of 2006, we recorded total other than temporary impairments of \$35 million attributable to the Financial Services Businesses, compared to total other than temporary impairments of \$31 million attributable to the Financial Services Businesses in the first nine months of 2005. The impairments in the first nine months of 2006 consisted of \$21 million relating to fixed maturities, \$8 million relating to equity securities and \$6 million relating to other invested assets as defined above. The impairments in the first nine months of 2005 consisted of \$23 million relating to fixed maturities, \$1 million relating to equity securities and \$7 million relating to other invested assets as defined above.

The impairments recorded on fixed maturities in the first nine months of 2006 consisted of \$14 million on public securities and \$7 million on private securities, compared with fixed maturity impairments of \$19 million on public securities and \$4 million on private securities in the first nine months of 2005. Impairments on fixed maturities in the first nine months of both 2006 and 2005 were concentrated in the manufacturing sector and were primarily driven by downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers.

*Closed Block Business*

For the Closed Block Business, net realized investment gains in the first nine months of 2006 were \$182 million, compared to net realized investment gains of \$510 million in the first nine months of 2005. Net realized gains on fixed maturity securities were \$1 million in the first nine months of 2006 and reflect private bond prepayment premiums of \$42 million and net gains on sales and maturities of fixed maturity securities of \$4 million, partially offset by impairments of \$31 million and credit losses of \$14 million. Net realized gains on fixed maturity securities were \$261 million in the first nine months of 2005 and relate primarily to net gains on sales of fixed maturity securities of \$233 million and private bond prepayment premiums of \$65 million, partially offset by impairments of \$29 million and credit-related losses of \$8 million. We realized net gains on equity securities of \$151 million in the first nine months of 2006, compared to net gains of \$206 million in the first nine months of 2005. The net realized gains on equity securities in the first nine months of 2006 and 2005 were

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primarily the result of sales pursuant to our active management strategy. Derivative losses were \$41 million in the first nine months of 2006, compared to derivative gains of \$39 million in the first nine months of 2005. Derivative losses in the first nine months of 2006 were primarily the result of currency derivatives used to hedge foreign fixed maturity investments of \$32 million. The derivative gains in the first nine months of 2005 were primarily related to interest rate swaps used to manage the duration of the fixed maturity investment portfolio. Net realized investment gains on other investments were \$71 million in the first nine months of 2006 primarily related to net gains from real estate related investments.

During the first nine months of 2006, we recorded total other than temporary impairments of \$49 million attributable to the Closed Block Business, compared to total other than temporary impairments of \$35 million attributable to the Closed Block Business in the first nine months of 2005. The impairments in the first nine months of 2006 consisted of \$31 million relating to fixed maturities, \$17 million relating to equity securities and \$1 million relating to other invested assets as defined above. The impairments in the first nine months of 2005 consisted of \$29 million relating to fixed maturities, \$4 million relating to equity securities and \$2 million relating to other invested assets as defined above.

The impairments recorded on fixed maturities in the first nine months of 2006 consist of \$8 million on public securities and \$23 million on private securities, compared with fixed maturity impairments of \$7 million on public securities and \$22 million on private securities in the first nine months of 2005. Impairments in the first nine months of 2006 were concentrated in the services and manufacturing sectors and were primarily driven by downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers. Included in private fixed maturity impairments for 2006 were impairments relating to an amusement ride manufacturer. Impairments in the first nine months of 2005 were concentrated in the manufacturing and utilities sectors and were primarily driven by downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers. Included in private fixed maturity impairments for 2005 were impairments relating to an electric power plant and an electronic test equipment distributor.

## **General Account Investments**

### ***Portfolio Composition***

Our investment portfolio consists of public and private fixed maturity securities, commercial loans, equity securities and other invested assets. The composition of our general account reflects, within the discipline provided by our risk management approach, our need for competitive results and the selection of diverse investment alternatives available primarily through our Asset Management segment. The size of our portfolio enables us to invest in asset classes that may be unavailable to the typical investor.

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Our total general account investments were \$223.2 billion and \$216.9 billion as of September 30, 2006 and December 31, 2005, respectively, which are segregated between the Financial Services Businesses and the Closed Block Business. Total general account investments attributable to the Financial Services Businesses were \$154.6 billion and \$149.4 billion as of September 30, 2006 and December 31, 2005, respectively, while total general account investments attributable to the Closed Block Business were \$68.6 billion and \$67.5 billion as of September 30, 2006 and December 31, 2005, respectively. The following table sets forth the composition of the investments of our general account as of the dates indicated.

	September 30, 2006			
	Financial Services Businesses	Closed Block Business	Total	% of Total
	(\$ in millions)			
Fixed Maturities:				
Public, available for sale, at fair value	\$ 89,176	\$ 37,732	\$ 126,908	56.9%
Public, held to maturity, at amortized cost	3,120		3,120	1.4
Private, available for sale, at fair value	18,074	11,999	30,073	13.5
Private, held to maturity, at amortized cost	353		353	0.1
Trading account assets supporting insurance liabilities, at fair value	14,453		14,453	6.5
Other trading account assets, at fair value	118		118	0.0
Equity securities, available for sale, at fair value	2,887	3,517	6,404	2.9
Commercial loans, at book value	16,877	7,243	24,120	10.8
Policy loans, at outstanding balance	3,350	5,407	8,757	3.9
Other long-term investments(1)	3,968	934	4,902	2.2
Short-term investments	2,188	1,773	3,961	1.8
<b>Total general account investments</b>	<b>154,564</b>	<b>68,605</b>	<b>223,169</b>	<b>100.0%</b>
Invested assets of other entities and operations(2)	5,742		5,742	
<b>Total investments</b>	<b>\$ 160,306</b>	<b>\$ 68,605</b>	<b>\$ 228,911</b>	

	December 31, 2005			
	Financial Services Businesses	Closed Block Business	Total	% of Total
	(\$ in millions)			
Fixed Maturities:				
Public, available for sale, at fair value	\$ 87,107	\$ 35,885	\$ 122,992	56.7%
Public, held to maturity, at amortized cost	3,022		3,022	1.4
Private, available for sale, at fair value	17,619	13,361	30,980	14.3
Private, held to maturity, at amortized cost	227		227	0.1
Trading account assets supporting insurance liabilities, at fair value	13,781		13,781	6.3
Other trading account assets, at fair value	124		124	0.1
Equity securities, available for sale, at fair value	2,624	3,216	5,840	2.7
Commercial loans, at book value	15,781	7,264	23,045	10.6
Policy loans, at outstanding balance	2,967	5,403	8,370	3.8
Other long-term investments(1)	3,725	973	4,698	2.2

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Short-term investments	2,456	1,394	3,850	1.8
Total general account investments	149,433	67,496	216,929	100.0%
Invested assets of other entities and operations(2)	4,472		4,472	
Total investments	\$ 153,905	\$ 67,496	\$ 221,401	

- (1) Other long-term investments consist of real estate and non-real estate related investments in joint ventures (other than our investment in operating joint ventures, including our investment in Wachovia Securities) and partnerships, investment real estate held through direct ownership, our interest in separate account investments and other miscellaneous investments.

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- (2) Includes invested assets of securities brokerage, securities trading, banking operations, real estate and relocation services, and asset management operations. Excludes assets of our asset management operations managed for third parties and those assets classified as separate account assets on our balance sheet.

The increase in general account investments attributable to the Financial Services Businesses in 2006 was primarily due to portfolio growth as a result of the reinvestment of net investment income and changes in foreign exchange rates, partially offset by the net decline in market values attributable to higher interest rates. Also contributing to the increase was the addition of investments related to the acquisition of the variable annuity business of The Allstate Corporation and the conversion of the modified coinsurance arrangement associated with the CIGNA defined benefit guaranteed-cost contracts to an indemnity coinsurance arrangement. The increase in general account investments attributable to the Closed Block Business in 2006 was primarily due to portfolio growth as a result of reinvestment of net investment income, partially offset by the net decline in market values attributable to higher interest rates.

We have substantial insurance operations in Japan, with 30% of our Financial Services Businesses' general account investments relating to our Japanese insurance operations as of both September 30, 2006 and December 31, 2005. The increase in our Japanese insurance operations' general account investments in 2006 is primarily attributable to portfolio growth as a result of increased annuity sales, the reinvestment of net investment income and changes in foreign currency exchange rates. The following table sets forth the composition of the investments of our Japanese insurance operations' general account as of the dates indicated.

	September 30, 2006	December 31, 2005
(in millions)		
<b>Fixed Maturities:</b>		
Public, available for sale, at fair value	\$ 31,646	\$ 30,757
Public, held to maturity, at amortized cost	3,120	3,022
Private, available for sale, at fair value	2,946	2,659
Private, held to maturity, at amortized cost	353	227
Trading account assets supporting insurance liabilities, at fair value	1,071	1,022
Other trading account assets, at fair value	28	26
Equity securities, available for sale, at fair value	2,288	2,021
Commercial loans, at book value	2,598	2,278
Policy loans, at outstanding balance	1,005	943
Other long-term investments(1)	890	941
Short-term investments	69	326
<b>Total Japanese general account investments(2)</b>	<b>\$ 46,014</b>	<b>\$ 44,222</b>

- (1) Other long-term investments consist of real estate and non-real estate related investments in joint ventures and partnerships, investment real estate held through direct ownership, our interest in separate account investments and other miscellaneous investments.
- (2) Excludes assets classified as separate accounts assets on our balance sheet.

Our Japanese insurance operations use the yen as their functional currency, as it is the currency in which they conduct the majority of their operations. Although the majority of the Japanese general account is invested in yen denominated investments, our Japanese insurance operations also hold significant investments denominated in U.S. dollars. As of September 30, 2006, our Japanese insurance operations had \$8.3 billion of investments denominated in U.S. dollars, including \$1.3 billion that were hedged to yen through third party derivative contracts. As of December 31, 2005, our Japanese insurance operations had \$7.4 billion of investments denominated in U.S. dollars, including \$1.7 billion that were hedged to yen through third party derivative contracts.





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

	Three Months Ended September 30, 2006					
	Financial Services Businesses		Closed Block Business		Combined	
	Yield(1)	Amount	Yield(1)	Amount	Yield(1)	Amount
	(\$ in millions)					
Fixed maturities	4.91%	\$ 1,362	6.55%	\$ 755	5.38%	\$ 2,117
Trading account assets supporting insurance liabilities	4.62	166			4.62	166
Equity securities	4.32	26	2.48	18	3.31	44
Commercial loans	6.02	249	7.25	130	6.39	379
Policy loans	4.95	41	6.18	83	5.72	124
Short-term investments and cash equivalents	4.68	91	3.13	47	4.56	138
Other investments	7.24	76	9.61	21	7.64	97
Gross investment income before investment expenses	5.06	2,011	6.41	1,054	5.44	3,065
Investment expenses	(0.24)	(129)	(0.22)	(140)	(0.23)	(269)
Investment income after investment expenses	4.82%	1,882	6.19%	914	5.21%	2,796
Investment results of other entities and operations(2)		75				75
Total investment income		\$ 1,957		\$ 914		\$ 2,871

	Three Months Ended September 30, 2005					
	Financial Services Businesses		Closed Block Business		Combined	
	Yield(1)	Amount	Yield(1)	Amount	Yield(1)	Amount
	(\$ in millions)					
Fixed maturities	4.63%	\$ 1,180	6.52%	\$ 712	5.19%	\$ 1,892
Trading account assets supporting insurance liabilities	4.23	147			4.23	147
Equity securities	4.57	25	2.44	15	3.44	40
Commercial loans	6.71	257	7.18	129	6.86	386
Policy loans	4.96	37	6.15	83	5.73	120
Short-term investments and cash equivalents	2.36	48	1.92	30	2.34	78
Other investments	8.71	83	25.45	59	11.94	142

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Gross investment income before investment expenses	4.87	1,777	6.62	1,028	5.38	2,805
Investment expenses	(0.19)	(90)	(0.22)	(97)	(0.20)	(187)
Investment income after investment expenses	4.68%	1,687	6.40%	931	5.18%	2,618
Investment results of other entities and operations(2)		47				47
Total investment income		\$ 1,734		\$ 931		\$ 2,665

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

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

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

The net investment income yield on our general account investments after investment expenses, excluding realized investment gains (losses), was 5.21% and 5.18% for the three months ended September 30, 2006 and 2005, respectively. The net investment income yield attributable to the Financial Services Businesses was 4.82% for the three months ended September 30, 2006, compared to 4.68% for the three months ended September 30, 2005. See below for a discussion of the change in the Financial Services Businesses' yields.

The net investment income yield attributable to the Closed Block Business was 6.19% for the three months ended September 30, 2006, compared to 6.40% for the three months ended September 30, 2005. The decrease was primarily due to less favorable results from private equity limited partnerships within other investments.

	<b>Nine Months Ended September 30, 2006</b>					
	<b>Financial Services Businesses</b>		<b>Closed Block Business</b>		<b>Combined</b>	
	<b>Yield(1)</b>	<b>Amount</b>	<b>Yield(1)</b>	<b>Amount</b>	<b>Yield(1)</b>	<b>Amount</b>
	(\$ in millions)					
Fixed maturities	4.90%	\$ 3,928	\$ 6.58	\$ 2,230	5.39%	\$ 6,158
Trading account assets supporting insurance liabilities	4.64	485			4.64	485
Equity securities	3.70	64	2.89	62	3.25	126
Commercial loans	6.16	734	7.69	405	6.63	1,139
Policy loans	4.93	115	6.25	248	5.76	363
Short-term investments and cash equivalents	4.60	241	7.22	139	5.01	380
Other investments	7.89	236	9.71	63	8.22	299
Gross investment income before investment expenses	5.07	5,803	6.55	3,147	5.50	8,950
Investment expenses	(0.23)	(353)	(0.24)	(395)	(0.23)	(748)
Investment income after investment expenses	4.84%	5,450	6.31%	2,752	5.27%	8,202
Investment results of other entities and operations(2)		179				179
Total investment income		\$ 5,629		\$ 2,752		\$ 8,381

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	Nine Months Ended September 30, 2005					
	Financial Services Businesses		Closed Block Business		Combined	
	Yield(1)	Amount	Yield(1)	Amount	Yield(1)	Amount
	(\$ in millions)					
Fixed maturities	4.63%	\$ 3,470	6.60%	\$ 2,108	5.21%	\$ 5,578
Trading account assets supporting insurance liabilities	4.19	420			4.19	420
Equity securities	4.15	67	2.92	53	3.50	120
Commercial loans	6.78	772	7.81	412	7.10	1,184
Policy loans	4.86	105	6.18	246	5.71	351
Short-term investments and cash equivalents	2.33	135	4.33	88	2.69	223
Other investments	6.89	204	21.22	146	9.58	350
Gross investment income before investment expenses	4.81	5,173	6.76	3,053	5.38	8,226
Investment expenses	(0.19)	(264)	(0.24)	(272)	(0.21)	(536)
Investment income after investment expenses	4.62%	4,909	6.52%	2,781	5.17%	7,690
Investment results of other entities and operations(2)		102				102
Total investment income		\$ 5,011		\$ 2,781		\$ 7,792

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

The net investment income yield on our general account investments after investment expenses, excluding realized investment gains (losses), was 5.27% and 5.17% for the nine months ended September 30, 2006 and 2005, respectively. The net investment income yield attributable to the Financial Services Businesses was 4.84% for the nine months ended September 30, 2006, compared to 4.62% for the nine months ended September 30, 2005. See below for a discussion of the change in the Financial Services Businesses yields.

The net investment income yield attributable to the Closed Block Business was 6.31% for the nine months ended September 30, 2006, compared to 6.52% for the nine months ended September 30, 2005. The decrease was primarily due to net declines in fixed maturity yields, primarily attributable to the impact of investment activities in a low interest rate environment and less favorable results from private equity limited partnerships within other investments.

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

	Three months ended September 30, 2006		Three months ended September 30, 2005	
	Yield(1)	Amount	Yield(1)	Amount
	(\$ in millions)			
Fixed maturities	6.29%	\$ 1,116	6.06%	\$ 961
Trading account assets supporting insurance liabilities	4.90	163	4.31	145
Equity securities	6.45	8	7.89	6
Commercial loans	6.38	224	7.28	229
Policy loans	5.56	32	5.70	28
Short-term investments and cash equivalents	4.75	85	2.63	47
Other investments	5.31	46	8.25	56
Gross investment income before investment expenses	6.02	1,674	5.91	1,472
Investment expenses	(0.28)	(106)	(0.19)	(69)
Investment income after investment expenses	5.74%	1,568	5.72%	1,403
Investment results of other entities and operations(2)		76		47
Total investment income		\$ 1,644		\$ 1,450

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

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The net investment income yield attributable to the non-Japanese operations portion of the Financial Services Businesses portfolio was 5.74% for the three months ended September 30, 2006, compared to 5.72% for the three months ended September 30, 2005. The increase was primarily due to an increase in the trading account assets yield due to reinvestment activities at higher rates. Also contributing to the increase was an increase in yields on fixed maturities and short-term investments and cash equivalents due to an increase in interest rates. The offsetting decrease in commercial loan yields is a result of reinvestment at lower rates and a lower level of prepayment premiums.

	Nine Months ended September 30, 2006		Nine Months ended September 30, 2005	
	Yield(1)	Amount	Yield(1)	Amount
(\$ in millions)				
Fixed maturities	6.27%	\$ 3,222	6.13%	\$ 2,834
Trading account assets supporting insurance liabilities	4.94	477	4.34	413
Equity securities	6.39	24	10.07	26
Commercial loans	6.61	669	7.42	682
Policy loans	5.56	89	5.63	80
Short-term investments and cash equivalents	4.67	228	2.71	132
Other investments	5.99	150	5.89	122
Gross investment income before investment expenses	6.06	4,859	5.91	4,289
Investment expenses	(0.25)	(286)	(0.20)	(200)
Investment income after investment expenses	5.81%	4,573	5.71%	4,089
Investment results of other entities and operations(2)		178		102
Total investment income		\$ 4,751		\$ 4,191

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

The net investment income yield attributable to the non-Japanese operations portion of the Financial Services Businesses portfolio was 5.81% for the nine months ended September 30, 2006, compared to 5.71% for the nine months ended September 30, 2005. The increase was primarily due to an increase in the trading account assets yield due to reinvestment activities, including reinvestment of sales proceeds, at higher rates. Also contributing to the increase was an increase in yields on fixed maturities and short-term investments and cash equivalents due to an increase in interest rates, including the benefit of reinvestment of proceeds from sales of fixed maturities at higher rates. The offsetting decrease in commercial loan yields is a result of reinvestment at lower rates and a lower level of prepayment premiums.

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

	Three months ended September 30, 2006		Three months ended September 30, 2005	
	Yield(1)	Amount	Yield(1)	Amount
	(\$ in millions)			
Fixed maturities	2.52%	\$ 246	2.30%	\$ 219
Trading account assets supporting insurance liabilities	1.08	2	0.99	2
Equity securities	3.76	18	4.35	19
Commercial loans	3.99	25	4.12	28
Policy loans	3.58	9	3.49	9
Short-term investments and cash equivalents	4.17	6	0.87	1
Other investments	13.03	30	8.91	27
Gross investment income before investment expenses	2.86	336	2.64	305
Investment expenses	(0.15)	(23)	(0.18)	(21)
Total investment income	2.71%	\$ 313	2.46%	\$ 284

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

The net investment income yield attributable to the Japanese insurance operations – portfolios was 2.71% for the three months ended September 30, 2006, compared to 2.46% for the three months ended September 30, 2005. The increase in yield on the Japanese insurance portfolio between periods is primarily attributable to an increase in U.S. dollar investments and the lengthening of the duration of the investment portfolio. Also contributing to the increase were more favorable results from joint venture investments within other investments. The yield on fixed maturities above includes the effect of U.S. dollar denominated fixed maturities that are not hedged to yen

through third party derivative contracts and provide a yield that is substantially higher than the yield on comparable Japanese fixed maturities. The average value of U.S. dollar denominated fixed maturities that are not hedged to yen through third party derivative contracts for the three months ended September 30, 2006 and 2005 was approximately \$6.8 billion and \$5.0 billion, respectively, based on amortized cost.

	Nine Months ended September 30, 2006		Nine Months ended September 30, 2005	
	Yield(1)	Amount	Yield(1)	Amount
	(\$ in millions)			
Fixed maturities	2.52%	\$ 706	2.26%	\$ 636
Trading account assets supporting insurance liabilities	0.99	8	1.04	7
Equity securities	2.95	40	3.13	41



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Commercial loans	3.66	66	4.10	90
Policy loans	3.57	26	3.40	25
Short-term investments and cash equivalents	3.89	13	0.50	3
Other investments	13.00	86	8.72	82
		<u>          </u>		<u>          </u>
Gross investment income before investment expenses	2.80	945	2.56	884
Investment expenses	(0.18)	(67)	(0.19)	(64)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total investment income	2.62%	\$ 878	2.37%	\$ 820
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

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

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

The net investment income yield attributable to the Japanese insurance operations portfolios was 2.62% for the nine months ended September 30, 2006, compared to 2.37% for the nine months ended September 30, 2005. The increase in yield on the Japanese insurance portfolio between periods is primarily attributable to an increase in U.S. dollar investments and the lengthening of the duration of the investment portfolio. Also contributing to the increase were more favorable results from joint venture investments within other investments. The yield on fixed maturities above includes the effect of U.S. dollar denominated fixed maturities that are not hedged to yen through third party derivative contracts and provide a yield that is substantially higher than the yield on comparable Japanese fixed maturities. The average value of U.S. dollar denominated fixed maturities that are not hedged to yen through third party derivative contracts for the nine months ended September 30, 2006 and 2005 was approximately \$6.1 billion and \$4.0 billion, respectively, based on amortized cost.

**Fixed Maturity Securities**

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

**Fixed Maturity Securities and Unrealized Gains and Losses by Industry Category**

The following table sets forth the composition of the portion of our fixed maturity securities portfolio by industry category attributable to the Financial Services Businesses as of the dates indicated and the associated gross unrealized gains and losses.

Industry(1)	September 30, 2006				December 31, 2005			
	Amortized Cost	Gross Unrealized Gains(2)	Gross Unrealized Losses(2)	Fair value	Amortized Cost	Gross Unrealized Gains(2)	Gross Unrealized Losses(2)	Fair Value
(in millions)								
Corporate Securities:								
Finance	\$ 16,984	\$ 325	\$ 98	\$ 17,211	\$ 15,034	\$ 337	\$ 86	\$ 15,285
Manufacturing	14,348	597	160	14,785	14,512	737	163	15,086
Utilities	9,151	460	74	9,537	8,404	523	60	8,867
Services	7,490	300	84	7,706	7,133	356	64	7,425
Energy	3,613	200	41	3,772	3,414	272	15	3,671
Retail and Wholesale	2,469	81	21	2,529	2,629	95	21	2,703
Transportation	2,401	132	22	2,511	2,355	158	10	2,503
Other	553	9	16	546	1,028	32	5	1,055
Total Corporate Securities	57,009	2,104	516	58,597	54,509	2,510	424	56,595
Foreign Government	25,005	587	132	25,460	24,695	929	48	25,576
Asset-Backed Securities	14,437	163	28	14,572	12,516	164	35	12,645
Mortgage Backed	8,866	74	64	8,876	9,376	97	97	9,376

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U.S. Government	2,811	345	11	3,145	3,357	412	7	3,762
Total	\$ 108,128	\$ 3,273	\$ 751	\$ 110,650	\$ 104,453	\$ 4,112	\$ 611	\$ 107,954

- (1) Investment data has been classified based on Lehman industry categorizations for domestic public holdings and similar classifications by industry for all other holdings.
- (2) Includes \$9 million of gross unrealized gains and \$82 million of gross unrealized losses as of September 30, 2006, compared to \$30 million of gross unrealized gains and \$51 million of gross unrealized losses as of December 31, 2005 on securities classified as held to maturity, which are not reflected in other comprehensive income.

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As a percentage of amortized cost, fixed maturity investments attributable to the Financial Services Businesses as of September 30, 2006, consist primarily of 23% foreign government sector, 16% finance sector, 13% asset-backed securities sector and 13% manufacturing sector compared to 24% foreign government sector, 14% finance sector, 14% manufacturing sector and 12% asset-backed securities sector as of December 31, 2005. As of September 30, 2006, 97% of the mortgage-backed securities in the Financial Services Businesses were publicly traded agency pass-through securities related to residential mortgage loans. Collateralized mortgage obligations represented the remaining 3% of mortgage-backed securities (and less than 1% of total fixed maturities in the Financial Services Businesses).

The gross unrealized losses related to our fixed maturity portfolio attributable to the Financial Services Businesses were \$0.8 billion as of September 30, 2006, compared to \$0.6 billion as of December 31, 2005. The gross unrealized losses as of September 30, 2006 were concentrated primarily in the manufacturing, foreign government and finance sectors and as of December 31, 2005 were concentrated primarily in the manufacturing, mortgage backed and finance sectors.

The following table sets forth the composition of the portion of our fixed maturity securities portfolio by industry category attributable to the Closed Block Business as of the dates indicated and the associated gross unrealized gains and losses.

Industry(1)	September 30, 2006				December 31, 2005			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(in millions)								
Corporate Securities:								
Manufacturing	\$ 8,622	\$ 362	\$ 92	\$ 8,892	\$ 8,480	\$ 468	\$ 88	\$ 8,860
Finance	7,676	130	43	7,763	6,687	155	44	6,798
Utilities	5,789	326	73	6,042	5,875	409	48	6,236
Services	4,689	212	47	4,854	4,722	273	34	4,961
Energy	2,126	138	17	2,247	2,177	201	4	2,374
Retail and Wholesale	1,720	76	12	1,784	1,845	98	15	1,928
Transportation	1,094	74	9	1,159	1,138	96	5	1,229
Other	13			13	24	4		28
<b>Total Corporate Securities</b>	<b>31,729</b>	<b>1,318</b>	<b>293</b>	<b>32,754</b>	<b>30,948</b>	<b>1,704</b>	<b>238</b>	<b>32,414</b>
Asset-Backed Securities	7,532	26	14	7,544	6,847	26	13	6,860
U.S. Government	4,340	400	7	4,733	4,828	579	2	5,405
Mortgage Backed	3,391	14	38	3,367	3,145	18	32	3,131
Foreign Government	1,192	145	4	1,333	1,266	175	5	1,436
<b>Total</b>	<b>\$ 48,184</b>	<b>\$ 1,903</b>	<b>\$ 356</b>	<b>\$ 49,731</b>	<b>\$ 47,034</b>	<b>\$ 2,502</b>	<b>\$ 290</b>	<b>\$ 49,246</b>

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

As a percentage of amortized cost, fixed maturity investments attributable to the Closed Block Business as of September 30, 2006 consist primarily of 18% manufacturing sector, 16% finance sector, 16% asset-backed securities sector, 12% utilities sector, and 10% services sector compared to 18% manufacturing sector, 15% asset-backed securities sector, 14% finance sector, 12% utilities sector, and 10% U.S. government sector as of December 31, 2005. As of September 30, 2006, 87% of the mortgage backed securities in the Closed Block Business were publicly

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traded agency pass-through securities related to residential mortgage loans. Collateralized mortgage obligations represented the remaining 13% of mortgage backed securities (and 1% of total fixed maturities in the Closed Block Business).

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The gross unrealized losses related to our fixed maturity portfolio attributable to the Closed Block Business were \$0.4 billion as of September 30, 2006 compared to \$0.3 billion as of December 31, 2005. The gross unrealized losses as of September 30, 2006 were concentrated primarily in the manufacturing, utilities and services sectors and as of December 31, 2005 were concentrated primarily in the manufacturing, utilities and finance sectors.

### *Fixed Maturity Securities Credit Quality*

The Securities Valuation Office, or SVO, of the National Association of Insurance Commissioners, or NAIC, evaluates the investments of insurers for regulatory reporting purposes and assigns fixed maturity securities to one of six categories called NAIC Designations. NAIC designations of 1 or 2 include fixed maturities considered investment grade, which include securities rated Baa3 or higher by Moody's or BBB- or higher by Standard & Poor's. NAIC Designations of 3 through 6 are referred to as below investment grade, which include securities rated Ba1 or lower by Moody's and BB+ or lower by Standard & Poor's. As a result of time lags between the funding of investments, the finalization of legal documents and the completion of the SVO filing process, the fixed maturity portfolio generally includes securities that have not yet been rated by the SVO as of each balance sheet date. Pending receipt of SVO ratings, the categorization of these securities by NAIC designation is based on the expected ratings indicated by internal analysis.

Investments of our international insurance companies are not subject to NAIC guidelines. Investments of our Japanese insurance operations are regulated locally by the Financial Services Agency, an agency of the Japanese government. The Financial Services Agency has its own investment quality criteria and risk control standards. Our Japanese insurance companies comply with the Financial Services Agency's credit quality review and risk monitoring guidelines. The credit quality ratings of the non-U.S. dollar denominated investments of our Japanese insurance companies are based on ratings assigned by Moody's, Standard & Poor's, or rating equivalents based on ratings assigned by Japanese credit ratings agencies.

The amortized cost of our public and private below investment grade fixed maturities attributable to the Financial Services Businesses totaled \$7.0 billion, or 6%, of the total fixed maturities as of September 30, 2006 and \$6.0 billion, or 6%, of the total fixed maturities as of December 31, 2005. Below investment grade fixed maturities represented 14% of the gross unrealized losses attributable to the Financial Services Businesses as of September 30, 2006 and December 31, 2005.

The amortized cost of our public and private below investment grade fixed maturities attributable to the Closed Block Business totaled \$6.3 billion, or 13%, of the total fixed maturities as of September 30, 2006 and \$5.9 billion, or 13%, of the total fixed maturities as of December 31, 2005. Below investment grade fixed maturities represented 24% of the gross unrealized losses attributable to the Closed Block Business as of September 30, 2006 and December 31, 2005.

**Table of Contents***Public Fixed Maturities Credit Quality*

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

(1) (2)	NAIC Designation	Rating Agency Equivalent	September 30, 2006				December 31, 2005			
			Amortized Cost	Gross Unrealized Gains(3)	Gross Unrealized Losses(3)	Fair Value	Amortized Cost	Gross Unrealized Gains(3)	Gross Unrealized Losses(3)	Fair Value
(in millions)										
1	Aaa, Aa, A		\$ 71,930	\$ 1,754	\$ 383	\$ 73,301	\$ 68,042	\$ 2,256	\$ 298	\$ 70,000
2	Baa		13,678	602	139	14,141	15,407	746	138	16,015
	Subtotal Investment Grade		85,608	2,356	522	87,442	83,449	3,002	436	86,015
3	Ba		2,845	94	41	2,898	2,711	124	43	2,792
4	B		1,716	78	35	1,759	1,109	71	20	1,160
5	C and lower		83	5	2	86	102	6	5	103
6	In or near default		37	7	2	42	28	10	1	37
	Subtotal Below Investment Grade		4,681	184	80	4,785	3,950	211	69	4,092
Total Public Fixed Maturities			\$ 90,289	\$ 2,540	\$ 602	\$ 92,227	\$ 87,399	\$ 3,213	\$ 505	\$ 90,107

- (1) Reflects equivalent ratings for investments of the international insurance operations that are not rated by U.S. insurance regulatory authorities.
- (2) Includes, as of September 30, 2006 and December 31, 2005, respectively, 14 securities with amortized cost of \$48 million (fair value, \$48 million) and 18 securities with amortized cost of \$146 million (fair value, \$147 million) that have been categorized based on expected NAIC designations pending receipt of SVO ratings.
- (3) Includes \$8 million of gross unrealized gains and \$77 million gross unrealized losses as of September 30, 2006, compared to \$29 million of gross unrealized gains and \$51 million of gross unrealized losses as of December 31, 2005 on securities classified as held to maturity that are not reflected in other comprehensive income.

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

(1)	NAIC Designation	Rating Agency Equivalent	September 30, 2006				December 31, 2005			
			Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(in millions)										
1	Aaa, Aa, A		\$ 25,728	\$ 825	\$ 127	\$ 26,426	\$ 24,159	\$ 1,108	\$ 109	\$ 25,158
2	Baa		6,449	276	71	6,654	6,424	353	56	6,721

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	Subtotal Investment Grade	32,177	1,101	198	33,080	30,583	1,461	165	31,879
3	Ba	2,531	82	33	2,580	2,459	119	33	2,545
4	B	1,953	38	31	1,960	1,332	38	19	1,351
5	C and lower	91	3	1	93	99	2	6	95
6	In or near default	18	3	2	19	13	3	1	15
	Subtotal Below Investment Grade	4,593	126	67	4,652	3,903	162	59	4,006
	<b>Total Public Fixed Maturities</b>	<b>\$ 36,770</b>	<b>\$ 1,227</b>	<b>\$ 265</b>	<b>\$ 37,732</b>	<b>\$ 34,486</b>	<b>\$ 1,623</b>	<b>\$ 224</b>	<b>\$ 35,885</b>

- (1) Includes, as of September 30, 2006 and December 31, 2005, respectively, 10 securities with amortized cost of \$32 million (fair value, \$32 million) and 8 securities with amortized cost of \$2 million (fair value, \$2 million) that have been categorized based on expected NAIC designations pending receipt of SVO ratings.



**Table of Contents***Private Fixed Maturities Credit Quality*

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

(1) (2)	NAIC Designation	Rating Agency Equivalent	September 30, 2006				December 31, 2005			
			Amortized Cost	Gross Unrealized Gains(3)	Gross Unrealized Losses(3)	Fair Value	Amortized Cost	Gross Unrealized Gains(3)	Gross Unrealized Losses(3)	Fair Value
(in millions)										
1	Aaa, Aa, A		\$ 5,702	\$ 231	\$ 42	\$ 5,891	\$ 5,596	\$ 269	\$ 27	\$ 5,838
2	Baa		9,799	401	81	10,119	9,437	522	63	9,896
	Subtotal Investment Grade		15,501	632	123	16,010	15,033	791	90	15,734
3	Ba		1,243	55	11	1,287	1,105	44	7	1,142
4	B		643	22	11	654	507	33	5	535
5	C and lower		304	18	3	319	339	23	2	360
6	In or near default		148	6	1	153	70	8	2	76
	Subtotal Below Investment Grade		2,338	101	26	2,413	2,021	108	16	2,113
	Total Private Fixed Maturities		\$ 17,839	\$ 733	\$ 149	\$ 18,423	\$ 17,054	\$ 899	\$ 106	\$ 17,847

- Reflects equivalent ratings for investments of the international insurance operations that are not rated by U.S. insurance regulatory authorities.
- Includes, as of September 30, 2006 and December 31, 2005, respectively, 219 securities with amortized cost of \$4,159 million (fair value, \$4,195 million) and 187 securities with amortized cost of \$3,494 million (fair value, \$3,542 million) that have been categorized based on expected NAIC designations pending receipt of SVO ratings.
- Includes \$1 million of gross unrealized gains and \$5 million of gross unrealized losses as of September 30, 2006, compared to \$1 million of gross unrealized gains and zero million of gross unrealized losses as of December 31, 2005 on securities classified as held to maturity that are not reflected in other comprehensive income.

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

(1)	NAIC Designation	Rating Agency Equivalent	September 30, 2006				December 31, 2005			
			Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(in millions)										
1	Aaa, Aa, A		\$ 2,921	\$ 183	\$ 22	\$ 3,082	\$ 3,079	\$ 208	\$ 16	\$ 3,271
2	Baa		6,773	369	50	7,092	7,487	549	39	7,997

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	Subtotal Investment Grade	9,694	552	72	10,174	10,566	757	55	11,268
3	Ba	1,167	81	13	1,235	1,195	69	8	1,256
4	B	376	22	5	393	570	15	2	583
5	C and lower	136	14	1	149	157	17	1	173
6	In or near default	41	7		48	60	21		81
	Subtotal Below Investment Grade	1,720	124	19	1,825	1,982	122	11	2,093
	Total Private Fixed Maturities	\$ 11,414	\$ 676	\$ 91	\$ 11,999	\$ 12,548	\$ 879	\$ 66	\$ 13,361

(1) Includes, as of September 30, 2006 and December 31, 2005, respectively, 117 securities with amortized cost of \$1,087 million (fair value, \$1,113 million) and 111 securities with amortized cost of \$1,479 million (fair value, \$1,543 million) that have been categorized based on expected NAIC designations pending receipt of SVO ratings.

**Table of Contents***Credit Derivative Exposure to Public Fixed Maturities*

In addition to the credit exposure from public fixed maturities noted above, we sell credit derivatives to enhance the return on our investment portfolio by creating credit exposure similar to an investment in public fixed maturity cash instruments.

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

The majority of referenced names in the credit derivatives where we have sold credit protection, as well as all the counterparties to these agreements, are investment grade credit quality and our credit derivatives generally have maturities of five years or less. As of September 30, 2006 and December 31, 2005, we had \$1,550 million and \$1,608 million, respectively, in outstanding notional amounts of credit derivative contracts where we have sold credit protection. The Financial Services Businesses had \$1,172 million and \$1,182 million of outstanding notional as of September 30, 2006 and December 31, 2005, respectively. The Closed Block Business had \$378 million and \$426 million, as of September 30, 2006 and December 31, 2005, respectively. Credit derivative contracts are recorded at fair value with changes in fair value, including the premium received, recorded in Realized investment gains (losses), net. The premium received for the credit derivatives we sell is included in adjusted operating income as an adjustment to Realized investment gains (losses), net over the life of the derivative.

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

(1) NAIC Designation	Rating Agency Equivalent	September 30, 2006		December 31, 2005	
		Notional	Fair Value	Notional	Fair Value
(in millions)					
1	Aaa, Aa, A	\$ 970	\$ 10	\$ 1,040	\$ (1)
2	Baa	182		132	(1)
	Subtotal Investment Grade	1,152	10	1,172	(2)
3	Ba	20		10	
4	B				
5	C and lower				
6	In or near default				
	Subtotal Below Investment Grade	20		10	
Total		\$ 1,172	\$ 10	\$ 1,182	\$ (2)

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

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

(1) NAIC Designation	Rating Agency Equivalent	September 30, 2006		December 31, 2005	
		Notional	Fair Value	Notional	Fair Value
(in millions)					
1	Aaa, Aa, A	\$ 363	\$ 4	\$ 396	\$ 3
2	Baa	10		30	
Subtotal Investment Grade		373	4	426	3
3	Ba	5			
4	B				
5	C and lower				
6	In or near default				
Subtotal Below Investment Grade		5			
Total		\$ 378	\$ 4	\$ 426	\$ 3

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

In addition to selling credit protection, in limited instances we have purchased credit protection using credit derivatives in order to hedge specific credit exposures in our investment portfolio. Similar to the above, the premium paid for the credit derivatives we purchase is included in adjusted operating income as an adjustment to Realized investment gains (losses), net over the life of the derivative.

*Unrealized Losses from Fixed Maturity Securities*

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

	September 30, 2006		December 31, 2005	
	Amortized Cost	Gross Unrealized Losses	Amortized Cost	Gross Unrealized Losses
(in millions)				
Less than nine months	\$ 32	\$ 7	\$ 33	\$ 8
Nine months or greater but less than nine months				
Nine months or greater but less than twelve months				

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Twelve months and greater

Total	\$ 32	\$ 7	\$ 33	\$ 8
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The gross unrealized losses as of both September 30, 2006 and December 31, 2005 were primarily concentrated in the manufacturing sector.

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

	September 30, 2006		December 31, 2005	
	Amortized Cost	Gross Unrealized Losses	Amortized Cost	Gross Unrealized Losses
	(in millions)			
Less than nine months	\$ 17	\$ 4	\$ 23	\$ 5
Nine months or greater but less than nine months				
Nine months or greater but less than twelve months				
Twelve months and greater				
<b>Total</b>	<b>\$ 17</b>	<b>\$ 4</b>	<b>\$ 23</b>	<b>\$ 5</b>

The gross unrealized losses as of both September 30, 2006 and December 31, 2005 were primarily concentrated in the manufacturing sector.

*Impairments of Fixed Maturity Securities*

We maintain separate monitoring processes for public and private fixed maturities and create watch lists to highlight securities that require special scrutiny and management. Our public fixed maturity asset managers formally review all public fixed maturity holdings on a quarterly basis and more frequently when necessary to identify potential credit deterioration whether due to ratings downgrades, unexpected price variances, and/or industry specific concerns. We classify public fixed maturity securities of issuers that have defaulted as securities not in good standing and all other public watch list assets as closely monitored.

For private placements our credit and portfolio management processes help ensure prudent controls over valuation and management. We have separate pricing and authorization processes to establish checks and balances for new investments. We apply consistent standards of credit analysis and due diligence for all transactions, whether they originate through our own in-house origination staff or through agents. Our regional offices closely monitor the portfolios in their regions. We set all valuation standards centrally, and we assess the fair value of all investments quarterly.

Our private fixed maturity asset managers conduct specific servicing tests on each investment on an ongoing basis to determine whether the investment is in compliance or should be placed on the watch list or assigned an early warning classification. We assign early warning classifications to those issuers that have failed a servicing test or experienced a minor covenant default, and we continue to monitor them for improvement or deterioration. In certain situations, the general account benefits from negotiated rate increases or fees resulting from a covenant breach. We assign closely monitored status to those investments that have been recently restructured or for which restructuring is a possibility due to substantial credit deterioration or material covenant defaults. We classify as not in good standing securities of issuers that are in more severe conditions, for example, bankruptcy or payment default.

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

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



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

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

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

When we determine that there is an other-than-temporary impairment, we record a writedown to estimated fair value, which reduces the cost basis. The new cost basis of an impaired security is not adjusted for subsequent increases in estimated fair value. In periods subsequent to the recognition of an other-than-temporary impairment, the impaired security is accounted for as if it had been purchased on the measurement date of the impairment. Accordingly, the discount (or reduced premium) based on the new cost basis is accreted into net investment income over the remaining life of the security based upon the amount and timing of expected future cash flows. Estimated fair values for fixed maturities, other than private placement securities, are based on quoted market prices or prices obtained from independent pricing services. For these private fixed maturities, fair value is determined typically by using a discounted cash flow model, which relies upon the average of spread surveys collected from private market intermediaries who are active in both primary and secondary transactions and takes into account, among other factors, the credit quality of the issuer and the reduced liquidity associated with private placements. The estimated fair value of certain non-performing private placement fixed maturities is based on management's estimates. Impairments on fixed maturity securities are included in Realized investment gains (losses), net and are excluded from adjusted operating income.

Impairments of fixed maturity securities attributable to the Financial Services Businesses were \$5 million and \$15 million for the three months ended September 30, 2006 and 2005, respectively and \$21 million and \$23 million for the nine months ended September 30, 2006 and September 30, 2005, respectively. Impairments of fixed maturity securities attributable to the Closed Block Business were \$12 million and \$10 million for the three months ended September 30, 2006 and 2005, respectively and \$31 million and \$29 million for the nine months ended September 30, 2006 and September 30, 2005, respectively. For a further discussion of impairments, see Realized Investment Gains above.

**Trading account assets supporting insurance liabilities**

Certain products included in the retirement business we acquired from CIGNA, as well as certain products included in the International Insurance segment, are experience-rated, meaning that the investment results associated with these products will ultimately accrue to contractholders. The investments supporting these experience-rated products, excluding commercial loans, are classified as trading. These trading investments are reflected on the balance sheet as Trading account assets supporting insurance liabilities, at fair value. Realized and unrealized gains and losses for these investments are reported in Asset management fees and other income. Investment income for these investments are reported in Net investment income. The following table sets forth the composition of this portfolio as of the dates indicated.

	September 30, 2006		December 31, 2005	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(in millions)			
Short-term Investments and Cash Equivalents	\$ 442	\$ 442	\$ 317	\$ 317
Fixed Maturities:				
U.S. Government	221	223	206	208
Foreign Government	333	335	329	330
Corporate Securities	9,994	9,800	9,207	8,980

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Asset-Backed Securities	660	655	685	679
Mortgage Backed	1,982	1,948	2,300	2,255
	<u>        </u>	<u>        </u>	<u>        </u>	<u>        </u>
Total Fixed Maturities	13,190	12,961	12,727	12,452
Equity Securities	857	1,050	811	1,012
	<u>        </u>	<u>        </u>	<u>        </u>	<u>        </u>
Total trading account assets supporting insurance liabilities	\$ 14,489	\$ 14,453	\$ 13,855	\$ 13,781
	<u>        </u>	<u>        </u>	<u>        </u>	<u>        </u>

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As of September 30, 2006, as a percentage of amortized cost, 75% of the portfolio was comprised of publicly traded securities, versus 71% of the portfolio as of December 31, 2005. As of September 30, 2006, 97% of the fixed maturity portfolio was classified as investment grade compared to 96% as of December 31, 2005. For a discussion of changes in the fair value of our trading account assets supporting insurance liabilities see Trading Account Assets Supporting Insurance Liabilities, below.

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

(1) (2)	NAIC Designation	Rating Agency Equivalent	September 30, 2006				December 31, 2005			
			Amortized Cost	Gross Unrealized Gains(3)	Gross Unrealized Losses(3)	Fair Value	Amortized Cost	Gross Unrealized Gains(3)	Gross Unrealized Losses(3)	Fair Value
(in millions)										
1	Aaa, Aa, A		\$ 7,667	\$ 28	\$ 121	\$ 7,574	\$ 6,599	\$ 14	\$ 138	\$ 6,475
2	Baa		1,867	2	47	1,822	2,017	3	63	1,957
	Subtotal Investment Grade		9,534	30	168	9,396	8,616	17	201	8,432
3	Ba		79		9	70	42		5	37
4	B		2			2	2			2
5	C and lower						2			2
6	In or near default									
	Subtotal Below Investment Grade		81		9	72	46		5	41
	Total Public Trading Account Assets Supporting Insurance Liabilities		\$ 9,615	\$ 30	\$ 177	\$ 9,468	\$ 8,662	\$ 17	\$ 206	\$ 8,473

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

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

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

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

(1) (2)	NAIC Designation	Rating Agency Equivalent	September 30, 2006				December 31, 2005			
			Amortized Cost	Gross Unrealized Gains(3)	Gross Unrealized Losses(3)	Fair Value	Amortized Cost	Gross Unrealized Gains(3)	Gross Unrealized Losses(3)	Fair Value
(in millions)										
1	Aaa, Aa, A		\$ 865	\$ 2	\$ 27	\$ 840	\$ 1,087	\$ 2	\$ 28	\$