

129 YEARS

15 MILLION CUSTOMERS

\$2.0 TRILLION LIFE INSURANCE
IN FORCE

prudential financial annual report
2004

30 COUNTRIES

\$500 BILLION ASSETS
UNDER MANAGEMENT

Prudential  Financial

Growing and Protecting Your Wealth®

We help grow and protect
wealth for more than

15

million customers.

Prudential Financial is one of the largest financial services companies in the United States. We offer individual and institutional clients a wide array of financial products and services, including life insurance, mutual funds, annuities, pension and retirement-related services and administration, asset management, securities brokerage, banking and trust services, real estate brokerage and relocation services. Today, 129 years after our founding, we have \$500 billion in assets under management, \$2 trillion in life insurance in force and more than 15 million customers in approximately 30 countries. We also have one of the most recognizable and trusted brand symbols in the world today: The Rock.®

Message from the Chairman

2004

marked another year of excellent progress.

Dear Fellow Shareholders:

In 2004, we continued the successful implementation of our Prudential Financial business strategy. We now possess a broad base of well-positioned businesses focused on growing and protecting wealth, both in the United States and key countries around the world. Each of our divisions—Insurance, Investment, and International Insurance and Investments—made material progress in 2004, while our capital management activities continue to add shareholder value. As a result, we are on track to achieve the goal I set three years ago—to deliver by the end of 2005 12 percent return on equity (ROE) based on after-tax adjusted operating income for the Financial Services Businesses, a financial measure we use to analyze our operating performance.*

Our results during the past year reflect a company that continued to strengthen its financial performance. In 2004, on a generally accepted accounting principles (GAAP) basis, our Financial Services Businesses posted net income of \$1.67 billion, or \$3.31 per share of Common Stock. That amounted to a 67 percent year-over-year increase in earnings per share.

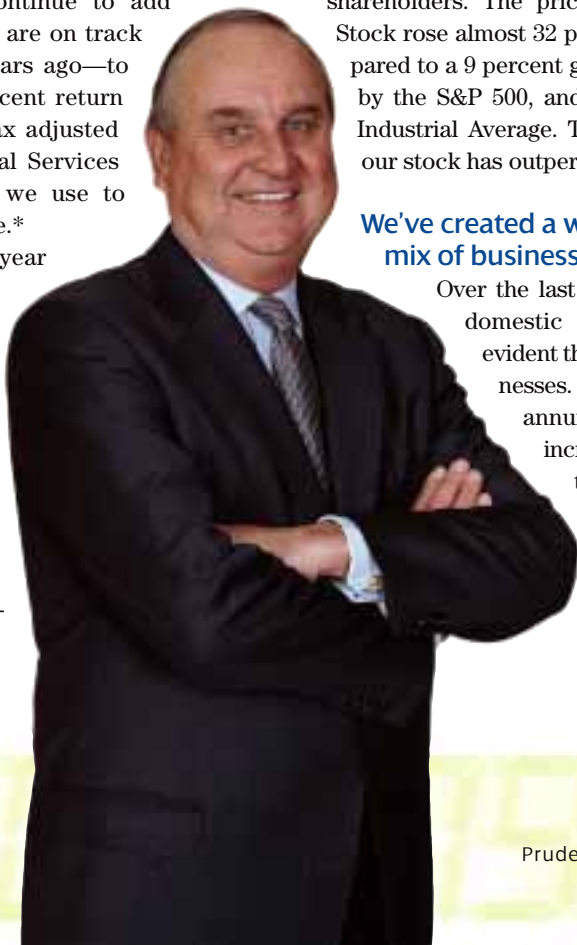
On a before-tax adjusted operating income basis, our Financial

Services Businesses earned \$2.50 billion in 2004, and based on after-tax adjusted operating income, earnings per share of Common Stock were \$3.61, an increase of 43 percent over 2003.

2004 held its challenges for us, including moderate stock market performance, low interest rates and continuing global unrest. In this environment, we delivered solid value for our shareholders. The price of Prudential Financial's Common Stock rose almost 32 percent over the 12-month period, compared to a 9 percent gain for the broad market, as measured by the S&P 500, and a 3 percent gain for the Dow Jones Industrial Average. That marks the third consecutive year our stock has outperformed both the S&P 500 and the Dow.

We've created a well-positioned mix of businesses

Over the last two years, we have strengthened our domestic operations. Nowhere is that more evident than in our retirement and annuities businesses. In terms of earnings, the retirement and annuities businesses combined have increased their contribution to Prudential's total before-tax adjusted operating income for the Financial Services Businesses from 6 percent in 2002 to 30 percent in 2004. This growth reflects the impact of two large acquisitions we made during that period.



* See footnote (A) on page 5 and footnote (1) on page 16.

Earnings per share of
Common Stock on a
GAAP basis were up

67

percent in 2004.

Our acquisition of American Skandia in May 2003 immediately positioned us in the top 10 in the variable annuities market, in terms of both sales and assets under management. In 2004, Prudential posted more than \$6 billion in gross annuity sales, compared to \$5 billion in 2003 and \$2 billion in 2002.

In April 2004, we acquired CIGNA Corporation's retirement business. This transaction propelled Prudential to a position as one of the leading providers of retirement products and services in the United States. The acquisition substantially increased our retirement assets under management, doubled our defined contribution participant base and account values, and provided complementary capabilities in areas such as defined benefit administration. We now have the scale and the broad spectrum of retirement products to better compete in this arena.

In our individual life insurance business, sales were up 12 percent over 2003. We have managed our product portfolio so that our offerings are both competitive and appropriately priced. We also continued to improve productivity among our agents. All of this was accompanied by a healthy increase in individual life insurance's adjusted operating income.

In our group insurance business, we remained committed to our strategy of controlled growth with an emphasis on profit margins. Group insur-

ance's new annualized premiums grew 8 percent in 2004, and we surpassed \$1 trillion of group life insurance coverage in force.

We continue to progress toward our goal of being a top 10 global asset manager. As of December 31, 2004, Prudential had \$500 billion in assets under management, an increase of 21 percent over year-end 2003. Part of this growth is attributable to the acquisitions we made throughout the year, most notably CIGNA, in which we took on the management of \$28 billion of proprietary assets.

We've developed a broader international presence

In 2004, we continued to strengthen our presence in key countries around the globe, both through organic growth and acquisitions. Our International Insurance and Investments Division continues to represent a significant share of our overall operations, accounting for 40 percent of Prudential's before-tax adjusted operating income for the Financial Services Businesses.

International insurance once again performed exceptionally well in 2004. Before-tax adjusted operating income was up 12 percent, and our policies in force outside the United States are now in excess of 6.7 million.

The cornerstone of those results is our Life Planner business model, which employs well-educated, highly trained professionals to sell life insurance in Japan, Korea, Taiwan and other countries around the world. Our 13-month policy persistency rate for our Life Planner business is 93 percent, 12-month Life Planner retention averages 73 percent, and from 1999 to 2004 our Life Planner force has grown annually at a double-digit rate, and our annualized new business premiums have grown proportionally.

Gibraltar Life, the traditional Japanese insurance business that we acquired in 2001, has been an impressive story as well.

Adjusted operating income was up 9 percent in 2004. Our Life Advisors average 3.7 policies sold per month, higher than the average of the top five competitors in Japan.

In November 2004, we acquired another book of life insurance business in Japan, Aoba Life, which added approximately 350,000 life insurance policies to our Life Planner business in that country.

Our international investments operations have benefited from the solid performance of Hyundai Investment and Securities, which we acquired in February 2004, leading to overall improved results.

For the second
consecutive year,
we increased our
annual Common Stock
dividend by 25
percent, to 62.5
cents per share.

2004

In March 2004, our joint venture with Everbright Securities Company received an operational license from the China Securities Regulatory Commission, and four months later we launched our first mutual fund product there. The venture gives us an entry point into the enormous potential of China's investment marketplace.

We've expanded our multi-channel distribution platform

While our proprietary agent force remains our primary sales channel in the United States for life insurance, the bulk of our sales growth is increasingly coming through independent financial professionals and other third-party distributors. In 2004, we grew third-party sales of individual life insurance products by 40 percent. We believe that with our strong brand, we can build on that growth going forward.

With our acquisition of American Skandia, we are now one of the leading providers of variable annuities through independent financial planners. We also created a fixed annuity product specifically for Wachovia Bank, where we are now the No. 3 provider of annuities.

In our managed accounts platform, assets under administration surpassed \$41 billion in 2004—double the amount for 2003. A large portion of this increase is the result of an agreement associated with our joint venture with Wachovia Securities.

We've continued effective capital and expense management

While we are committed to improving Prudential's operating performance, we are also highly focused on maintaining our financial strength. In 2004, we reinvested capital in acquisitions that have helped us improve our return on equity. Even after these acquisitions, our balance sheet and capital position continue to be consistent with our ratings objectives. We also met our expense management targets. As part of our overall capital management, we have been able to return value to our shareholders through share repurchases and increased dividends.

Over the last two years, we have invested nearly \$4 billion in acquisitions, including American Skandia, CIGNA retirement, Hyundai Investment and Aoba Life. For the second consecutive year, we increased our annual Common Stock dividend by 25 percent, to 62.5 cents per share. In addition, we repurchased \$1.5 billion in Common Stock.

We were rewarded for our strong financial results and our strengthened balance sheet with upgrades from three major ratings agencies. In 2004, Standard and Poor's, Moody's Investors Service and A.M. Best all upgraded Prudential's insurance finan-

We have built a strong foundation for growth and are better positioned than ever to capitalize on opportunities in the marketplace.

cial strength ratings—to AA- (Very Strong), Aa3 (Excellent) and A+ (Superior), respectively. We intend to maintain these ratings levels by continuing to manage our capital to strict standards while growing our earnings.

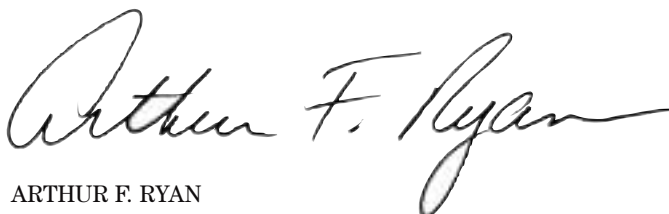
We've positioned ourselves for double-digit growth

I'm pleased with the performance our company delivered in 2004. More importantly, the actions we have taken have strengthened our long-term growth prospects.

We have the right mix of businesses to help people grow and protect their wealth—insurance, investments, annuities, retirement services and asset management. We will continue to build on those capabilities. We have well-diversified sources of earnings, which can help us prosper under difficult market conditions. We will continue to focus on the quality and consistency of those earnings. We strengthened our position in selective international markets. We will continue to focus on this in 2005. We substantially increased sales of our insurance and annuities products through third parties. We will continue to look for opportunities to expand our distribution platform. We have deployed a greater amount of capital in our higher-return businesses, namely in our international, retirement and annuities businesses. In 2005, we will continue to allocate capital in line with market opportunities, including making acquisitions where they make sense. Our employees continued to demonstrate their deep commitment to Prudential and to growing our business. I am confident that this unyielding commitment will continue in 2005 and beyond.

As we enter 2005, we are well-positioned not only to reach our goal of 12 percent ROE, but also to deliver double-digit growth in earnings and earnings per share, as measured by adjusted operating income. We have built a strong foundation for growth and are better positioned than ever to capitalize on opportunities in the marketplace.

We are excited about our future, and on behalf of everyone at Prudential, I want to thank you, our shareholders, for your confidence and support. ●



ARTHUR F. RYAN
Chairman and Chief Executive Officer

Financial highlights

Financial Services Businesses

In millions, except per share amounts

For the years ended December 31,	2004	2003	2002
RESULTS BASED ON ADJUSTED OPERATING INCOME (A)			
Revenues	\$ 19,985	\$ 18,108	\$ 18,141
Benefits and expenses	17,478	16,134	16,401
Adjusted operating income before income taxes	\$ 2,507	\$ 1,974	\$ 1,740
Operating return on average equity (B)	10.16%	7.55%	6.35%
GAAP RESULTS			
Revenues	\$ 20,117	\$ 19,906	\$ 19,157
Benefits and expenses	17,745	18,297	18,318
Income from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change	\$ 2,372	\$ 1,609	\$ 839
Return on average equity (B)	8.95%	5.48%	3.95%
EARNINGS PER SHARE OF COMMON STOCK - diluted			
Adjusted operating income after income taxes	\$ 3.61	\$ 2.53	\$ 2.07
Reconciling items:			
Investment gains (losses), net	(0.06)	(0.36)	(1.50)
Other reconciling items	(0.20)	(0.30)	(0.06)
Tax benefit on above	0.10	0.21	0.87
Income from continuing operations (after-tax) before extraordinary gain on acquisition and cumulative effect of accounting change	\$ 3.45	\$ 2.08	\$ 1.38

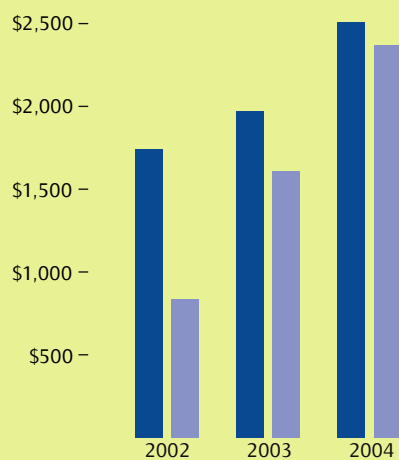
Consolidated Information

In millions, unless otherwise noted

As of or for the years ended December 31,	2004	2003	2002
GAAP RESULTS			
Total revenues	\$ 28,348	\$ 27,888	\$ 26,278
Income (loss) after income taxes:			
Continuing operations before extraordinary gain on acquisition and cumulative effect of accounting change	\$ 2,332	\$ 1,322	\$ 270
Impact of discontinued operations, extraordinary gain on acquisition and cumulative effect of accounting change	\$ (76)	\$ (58)	\$ (76)
Net income (loss):			
Financial Services Businesses	\$ 1,674	\$ 1,025	\$ 679
Closed Block Business	582	239	(485)
Consolidated net income	\$ 2,256	\$ 1,264	\$ 194
FINANCIAL POSITION			
Invested assets	\$ 216,624	\$ 181,041	\$ 183,208
Total assets	\$ 401,058	\$ 321,274	\$ 292,616
Attributed equity:			
Financial Services Businesses	\$ 21,209	\$ 20,340	\$ 20,562
Closed Block Business	1,135	952	768
Total equity	\$ 22,344	\$ 21,292	\$ 21,330
Assets under management (in billions)	\$ 500	\$ 414	\$ 378

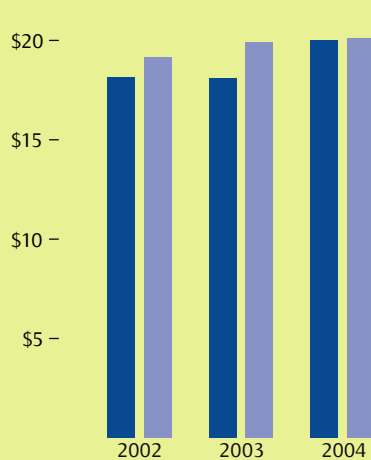
Financial Services Businesses Adjusted Operating Income^(A) and Income from Continuing Operations (pre-tax, in millions)

Adjusted operating income
Income from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change (GAAP)



Financial Services Businesses Adjusted Operating Revenues^(A) and GAAP Revenues (in billions)

Adjusted operating revenues
Revenues (GAAP)



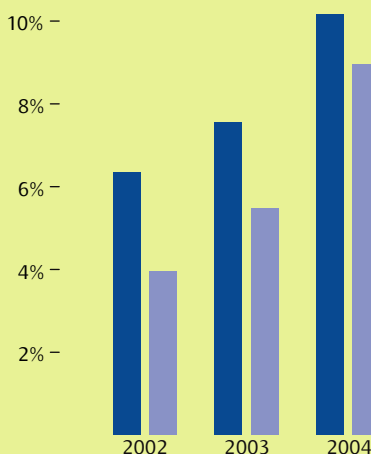
(A) Adjusted operating income is a non-GAAP measure that excludes net realized investment gains and losses (other than those associated with terminating hedges of foreign currency earnings and current period yield adjustments), and related charges and adjustments; net investment gains and losses on trading account assets supporting insurance liabilities; change in experience-rated contractholder liabilities due to asset value changes; results of divested businesses and discontinued operations; individual life insurance sales practices remedies and costs; cumulative effect of accounting change; extraordinary gain on acquisition; and the related tax effects thereof. Revenues and benefits and expenses shown as components of adjusted operating income are presented on the same basis and exclude these items as well. See Management's Discussion and Analysis of Financial Condition and Results of Operations for further discussion of adjusted operating results and the Consolidated Financial Statements for a reconciliation of results based on adjusted operating income to GAAP results.

Assets Under Management (in billions)



Financial Services Businesses Operating Return on Average Equity^(B) and Return on Average Equity^(B)

Operating return on average equity
Return on average equity



(B) Operating return on average equity is calculated by dividing adjusted operating income after income taxes by average attributed equity for the Financial Services Businesses excluding unrealized gains and losses on investments. An alternative measure to operating return on average equity is return on average equity. Return on average equity is calculated by dividing income from continuing operations by average total attributed equity for the Financial Services Businesses. Both income amounts above give effect to the direct equity adjustment for earnings per share calculation.

The positive results we achieved in 2004 stemmed in large part from actions we've taken in our first three years as a public company to strengthen our core businesses and seize potential growth opportunities.

Our domestic protection businesses—individual life and group insurance—each contributed to our earnings improvement, reflecting steps taken to increase our productivity and make us more competitive in today's marketplace.

We have enhanced our position in the U.S. retirement and annuities markets through two acquisitions, both of which contributed to our strong earnings. In 2004, we substantially completed the integration of American Skandia into our annuities business. We also acquired the retirement business of CIGNA, which has significantly bolstered our presence in this fast-growing market.

In all of our insurance businesses, our first priority is protecting people's financial security. Prudential life insurance policies protect millions of individuals in the United States.

We take that commitment seriously. In 2004, we paid out almost \$2.5 billion in death benefits to the beneficiaries of our U.S. individual life policyholders. And we have taken a number of important steps to strengthen our domestic individual life insurance business.

Before-tax adjusted operating income for our individual life insurance business in 2004 was \$390 million, a \$33 million increase over 2003. Sales of our individual life insurance products, excluding corporate-owned life insurance, grew 15 percent to \$391 million.

Third-party individual life insurance sales were up 40 percent

The majority of our individual life insurance sales continued to come from Prudential agents, and sales through this channel increased in 2004. A key objective for our individual life

We delivered nearly

A large, stylized blue graphic of the number \$2.5, rendered in a 3D blocky font with a slight shadow effect, positioned centrally in the right half of the page.

billion in individual life insurance benefits

insurance business has been growing third-party sales, and we continued to deepen our penetration of this distribution channel in 2004. Much of our strong sales growth is attributable to third-party channels. Sales of our individual life insurance products through these channels were up 40 percent over 2003.

This reflects our ongoing efforts to strengthen our relationships with some of the premier financial services distribution firms in the industry. By leveraging our strong brand and pene-

We earned ratings upgrades from 3 agencies

In 2004, three major ratings agencies upgraded Prudential's insurance financial strength ratings. Standard & Poor's upgraded our rating to AA- (Very Strong), A.M. Best gave us an A+ (Superior) rating and Moody's Investors Service upgraded us to Aa3 (Excellent).

In addition to affirming the claims-paying ability of our life insurance business, the upgrades enhance the attractiveness of our products in the marketplace and improve our position with third-party distributors.



Our simplified Life Xpress worksheet means Prudential agents like Brian Kazinec can now initiate the life insurance underwriting process more quickly.

trating profitable new distribution channels, we intend to continue growing third-party sales of our individual life insurance products in 2005.

Universal life insurance sales grew 35 percent

We maintained a healthy mix of products in our individual life insurance portfolio. In 2004, our universal life insurance products led the way, with a 35 percent increase in sales over 2003, reflecting the market's current emphasis on that product line and the traction of Prudential's universal life insurance products in particular.

We continue our practice of routinely evaluating and repricing our individual life insurance products, when appropriate, to make them more competitive in the marketplace. One result of this effort in 2004 was a 5 percent year-over-year increase in term life sales.

Sales of our variable life insurance products were relatively stable for the year. Our sales results show that we are not reliant on any one product.

We deliver underwriting decisions within 72 hours

We understand that customer satisfaction is directly related to how easy it is to do business with us. In 2004, we made significant service enhancements in individual life insurance to ensure that it's easier than ever for our clients, our agents and our distribution partners to do business with us.

We improved Prudential Xpress, our Web-based platform that gives third-party distributors sophisticated tools and information to market Prudential individual life insurance products and initiate business with us. In addition, we introduced a simplified one-page Life Xpress application worksheet for our agents. The worksheet can now be submitted online, which means the underwriting process is initiated more quickly, saving time for both our clients and our agents. We also enhanced our case status system. Now our agents are automatically notified of underwriting decisions within 72 hours of receiving the medical requirements.

Our surveys indicate that these enhancements have helped to improve our service delivery in the eyes of our customers. The vast majority of clients who did business with us in 2004 were very satisfied with the accuracy and timeliness of our service.

We surpassed \$1 trillion in group life insurance in force

Prudential has long been a dominant presence in the group life insurance market. We now provide more than \$1 trillion of group life insurance coverage to America's workforce, a claim few other companies can make.

With about 13,000 life policies covering more than 14 million lives, we count some of the largest, most respected companies in the world among our clients. More than 70 Fortune 500 companies and one-quarter of Fortune 100 firms have turned to us for their group insurance needs.

According to our most recent client satisfaction survey, 93 percent of our clients were satisfied with Prudential as their provider of group life benefits. And our policy persistency ratio on group life remains strong at 94 percent. In fact, we have clients who have been with us for more than 75 years. ●

Clients entrust us with

\$181

billion of their retirement
and annuity assets

Today's U.S. retirement market

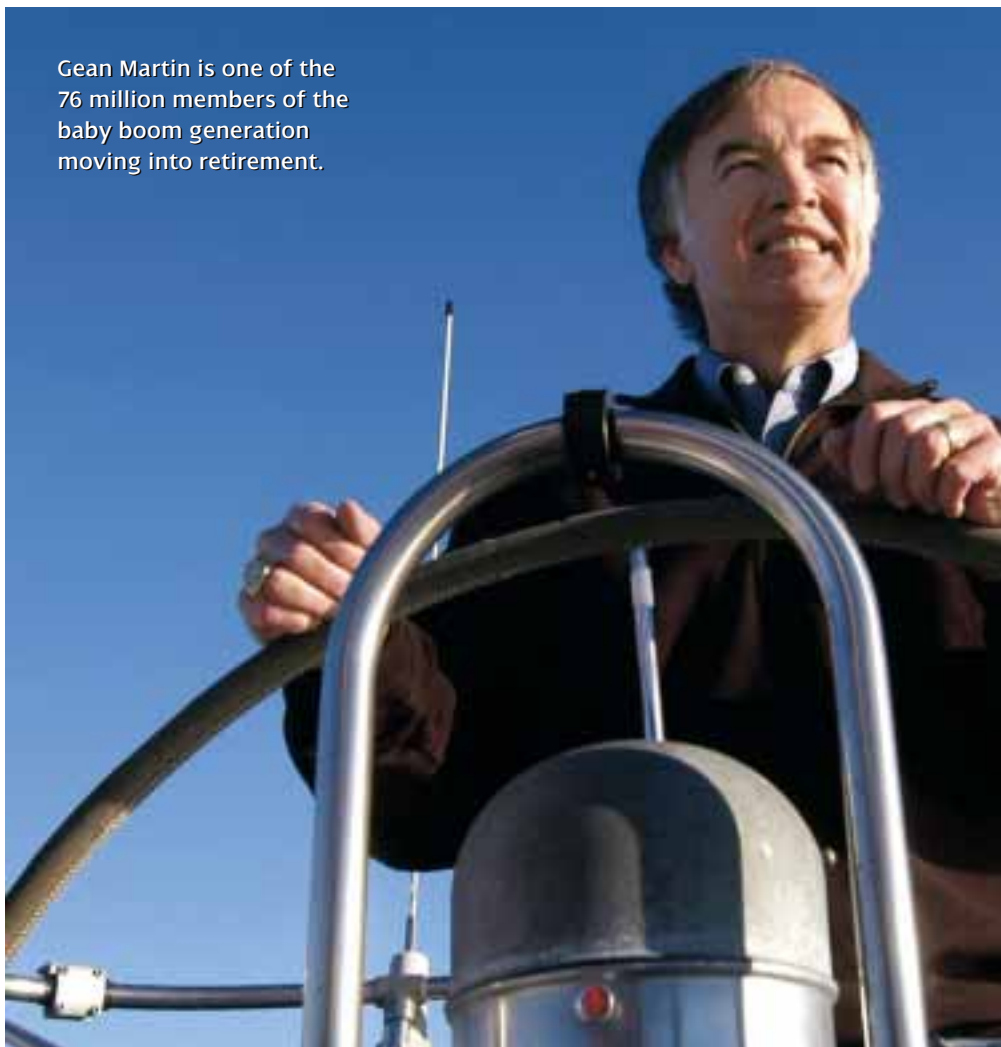
is estimated at \$19 trillion. During the next decade and a half, 76 million people in the baby boom generation will be moving into retirement—more than at any time in American history. And the retirement market is expected to reach \$39 trillion by 2012. That presents a significant growth opportunity for Prudential Financial's retirement and annuities businesses.

Over the last two years, we have added considerable scale and breadth to both our retirement and annuities businesses. These two businesses combined have increased their contribution to our total before-tax adjusted operating income for the Financial Services Businesses from 6 percent in 2002 to 30 percent in 2004. And the account values in our retirement and annuity products have more than doubled from 2002 to 2004, to \$181 billion. Much of this growth reflects two acquisitions we made during that time period—that of American Skandia and CIGNA's retirement business.

**We have 2 million defined
contribution plan participants**

We acquired CIGNA's retirement business in April 2004. The acquisition sub-

Gean Martin is one of the
76 million members of the
baby boom generation
moving into retirement.



stantially increased our retirement assets to \$130 billion, more than doubled our defined contribution recordkeeping account values to \$67 billion, and doubled our defined contribution plan participants to 2 million at more than 5,000 institutions.

The acquisition also broadened both our distribution platform and our market penetration. Prior to the acquisition, most of our sales activity was generated by our own sales force and concentrated on retirement plans for small companies and not-for-profit organizations. The CIGNA deal added capabilities in the large company 401(k) market as well as a new distribution channel, retirement and investment brokers and consultants.

We're a top-10 provider of variable annuities

Our annuity business was strengthened by the acquisition of American Skandia in 2003.

The U.S. retirement and annuity markets hold strong growth prospects over the long term, and we are better positioned than ever to meet the growing needs of this market.

sition of American Skandia in 2003. The acquisition propelled us to a leadership position in the annuity market. Prior to the addition of American Skandia, account values in our annuities business were \$19 billion. At the end of 2004, they totaled \$51 billion. And gross sales of our annuity products grew from \$2 billion in 2002 to more than \$6 billion in 2004. We are now a top-10 provider of variable annuities in the U.S. market, in terms of sales and assets under management.

We have also significantly increased our distribution capability. Because American Skandia is one of the leading providers of variable annuities through independent financial planners in the United States, we now have a well-established third-party channel through which to distribute our annuity products—a channel we were not active in prior to the acquisition. While Prudential agents will continue to be an important distribution arm for us, 76 percent of our annuity sales now come through third parties.

While more than 90 percent of our sales are in variable annuities, fixed annuities provide an important balance to our portfolio. In 2004, we created a fixed annuity product exclusively for Wachovia Bank. As of the end of 2004, we were the No. 3 seller of annuity products through the bank.

The U.S. retirement and annuity markets hold strong growth prospects over the long term, and we are better positioned than ever to meet the growing needs of this market. ●

Our defined contribution plans won 24 'Best In Class' awards

When it comes to delivering retirement plan services, we earn high marks from plan sponsors. In *PLANSponsor* magazine's 2004 defined contribution services survey, Prudential won 24 "Best In Class" awards across an array of categories in three plan sizes—small, middle and large.

The Best In Class awards are given to those providers who earn top-quartile scores within each service category. The services we provide plan participants were highly regarded, especially in the areas of the range of investment options we offer, the value of our communications materials and the timeliness of our reporting. And plan sponsors said we excelled in such categories as the expertise of our account representatives, our responsiveness to questions and our compliance with investment policy. We continue to raise the bar in terms of product features and service support.

We manage

\$500

billion in assets

The depth and breadth of our investment capabilities, and the broad diversification of our asset sources have helped us make progress in the asset management arena.

At the end of 2004, we held \$500 billion in assets under management, an increase of 21 percent over year-end 2003.

Net inflows from institutional clients totaled \$10 billion

With almost \$120 billion in assets under management from institutional clients at year-end 2004, Prudential has a strong presence in the institutional investment marketplace. Net inflows in our institutional investment business totaled nearly \$10 billion, with increases in the equity, fixed income and real estate asset classes.

We are one of the largest fixed income managers in the United States,



Apartment complexes, including Signature Point Apartments in San Diego, Calif., make up almost 20 percent of the real estate investments we manage on behalf of institutional investors.

Prudential Real Estate sales volume hit \$185 billion

For the fourth straight year, home sales in the United States hit record highs. In 2004, more than 6.6 million homes were sold nationwide.

Prudential Real Estate had a banner year as well, with \$185 billion in network sales volume, \$31 billion higher than in 2003. It added 100 agencies and 8,000 sales professionals to its franchise network, which is now more than 58,000 strong.

In 2004, we enhanced our clients' home search capabilities by acquiring eRealty, a Web-based real estate transaction services provider. By incorporating eRealty's proprietary technology onto our platform, we now offer clients a single source for all available home listings in their market through www.prudential.com.

We also signed an exclusive multi-year marketing agreement with Yahoo!. Visitors to the Yahoo! Real Estate site, which average 2 million a month, are connected directly to comprehensive real estate listing information from a Prudential Real Estate broker in the area.



We are one of
the largest fixed
income managers in
the United States, and
we built on our
success in 2004.

and we built on our success in 2004, especially in the alternative investment products market. We added more than \$2.8 billion in assets under management in collateralized debt obligations.

We increased assets in our managed account platform by 109 percent

Managed accounts are one of the fastest-growing segments of the retail marketplace. Prudential's managed account business, which provides access to more than 60 professional money managers as well as individually managed accounts and mutual funds, is well positioned to capitalize on that growth.

In 2004, we more than doubled the assets under administra-

tion in our managed accounts platform, to \$41 billion, largely due to our assumption of administrative responsibility for Wachovia Securities customer accounts.

In our retail investment businesses, we have a robust platform for advice-giving and research; high-quality investment managers to support a proprietary fund family; and an established family of subadvised funds that is well-adapted to meet the needs of advisors who opt not to use proprietary-managed funds. We believe these are the tools we will need to compete in tomorrow's retail marketplace. ●

There is no question that the international marketplace offers the potential for faster growth than the U.S. market. In 2004, Prudential's international operations continued to perform and are well-positioned to capitalize on future opportunities.

In our international insurance businesses, we continued in 2004 to differentiate ourselves with our client-centered distribution systems and our focus on providing quality protection products.

In our international investments operations, we're seeing results from our acquisition in February 2004 of Hyundai Investment and Securities, which has enhanced our ability to serve retail and institutional clients alike in the Korean market.

We believe we're poised to seize new opportunities that will capitalize on our strengths and broaden our presence in the countries where we choose to do business.

Our International Insurance business remains a significant growth engine for the company. In 2004, before-tax adjusted operating income increased 12 percent over 2003 and contributed 37 percent of Prudential's before-tax adjusted operating income for the Financial Services Businesses.

Key to International Insurance's success is its unique Life Planner business model, which relies on a distribution force composed of well-educated, highly trained sales professionals, selling protection life insurance products to an affluent clientele via a needs-based approach. This model gives us a competitive advantage in the eight countries where we've deployed it, most notably in Japan and Korea.

Our Life Planner operations have a proven track record of double-digit growth. From 1999 to 2004, annualized new business premiums, on a constant currency basis, grew at a double-digit annual compound rate, as did the number of individual policies in force.

We also offer life insurance products to the broad middle-income market across Japan, using a more traditional distribution model through our force of Life Advisors, who are employed by Gibraltar Life, a company we acquired in 2001. Since then, we've implemented some of the successful features of our Life Planner business model at Gibraltar, helping to spur improvements in Life Advisor productivity.

The combination of these two approaches gives us more ways to serve customers in a market with solid growth potential.

We now have an international field force exceeding 10,000

To continue to expand our market share, it's important that we increase the number of Life Planners we have, something we have done for six straight years. In 2004, our Life Planner force surpassed 5,300, compared with just under 5,000 at year-end 2003. In fact, from 1999 to 2004, our Life Planner force grew at a compound rate of 13 percent a year.

The high rates of both Life Planner retention and policy persistency that we have achieved point to the caliber of our field force and the quality of the sales they make. Across all eight countries where we operate—Japan, Korea, Taiwan, Italy, the Philippines, Poland, Brazil and Argentina—12-month Life Planner retention averaged 73 percent, and policy persistency, based on face amount, averaged an impressive 93 percent after 13 months.

Gibraltar Life also has developed a strong field force. Since acquiring the company, we have devoted considerable resources toward recruiting, training and improving the productivity of Gibraltar's nearly 5,000 Life Advisors. These efforts are getting results. Since becoming a Prudential company, Gibraltar has significantly increased both Life Advisor productivity and policy persistency. Gibraltar's

International
Insurance garnered

\$945

million in
annualized new
business premiums





Prudential of Japan's Naoko Hasegawa is one of more than 10,000 sales professionals throughout our International Insurance operations.

Our Life
Planner operations
have a proven track
record of double-
digit growth.

Life Advisor 13-month policy persistency, based on face amount, averaged almost 94 percent at the end of 2004, among the highest in the industry.

We're committed to our Life Planner and Life Advisor distribution models because they work. We remain focused on protection products because that's what our clients need. We employ strict financial discipline in each of our international insurance businesses so we generate significantly more capital than we need to operate our businesses, enhancing our financial flexibility.

In countries like Japan, Korea and Taiwan, where we already have established businesses, we'll continue to deploy capital to expand our operations organically. In addition, we will pursue opportunistic acquisitions when appropriate—where they offer attractive returns and add to our scale, our presence and our capabilities in the markets in which we have chosen to operate.

We're the No. 1 foreign-owned asset manager in Korea

The international investments business reported before-tax adjusted operating income of \$86 million, a substantial gain over 2003. Prudential Investment & Securities Company, formerly known as Hyundai Investment and Securities Co., a Korean investment firm we acquired in February 2004, contributed much of the increase. The acquisition made Prudential the largest foreign-owned asset manager in Korea, based on assets under management.

We entered China's 1.3 billion strong marketplace

With one of the fastest-growing economies in the world, a population of 1.3 billion and the largest share of foreign direct investments, China is one of the most attractive emerging markets for the investment fund management business.

Our joint venture with Shanghai-based Everbright Securities Co.—one of the leading financial services companies in the country—gives us an entry point into the enormous potential of China's investment marketplace.

In March 2004, Everbright Pramerica Fund Management, as the joint venture is now called, received an operational license from the China Securities Regulatory Commission. Four months later, we launched our first mutual fund product there, which raised more than \$300 million in the one-month issuing period.

In 2005 we plan to expand our offerings for China's retail and institutional investors by building a diversified product line that is adaptable to changing market conditions. •

Prudential of Japan gained 350,000 policies through acquisition

We further strengthened our position in the Japanese life insurance market in late 2004 when we acquired Aoba Life Insurance Company, Ltd. Adding Aoba's business to our existing insurance operations in Japan—Prudential of Japan and Gibraltar Life—makes Prudential the largest foreign-owned life insurance operation in the country, based on face amount in force.

Through the acquisition of Aoba, we boosted our assets by \$6 billion and added approximately 350,000 individual insurance policies to our book of business. We also expect to realize cost savings through the consolidation of overlapping functions and office locations.



Ignace Conic was one of 10 Prudential employees who took time out of their busy schedules to bring the book "The Little Red Hen" to life for 100 children at the Friendly Fuld Neighborhood Center in Newark, N.J., a Prudential Foundation grant recipient.

We made more than

\$23


million in grants
to strengthen
our communities

The concept of "community" is at the heart of Prudential. That's because we're in the business of helping people—to grow and protect their wealth, to build secure futures and to protect their loved ones.

We believe it's also our business to invest in a better quality of life in the communities where we live and work. Through Prudential's Community Resources group, we coordinate grants, social investments, employee volunteerism and strategic partnerships that build more productive, economically empowered neighborhoods and cities around the world.

Since 1977, The Prudential Foundation, the company's nonprofit grant-making unit, has been promoting community revitalization through targeted donations. In 2004, the Foundation provided grants totaling more than \$23 million to hundreds of organizations around the country.

The Foundation channels its grants through three distinct program areas. The Ready to Learn program funds initiatives that strengthen public school education. The Ready to Work program targets organizations that increase employment opportunities by fostering neighborhood economic development and helping individuals improve job-related skills. The Ready to Live program promotes community well-being through initiatives that help build healthy families and support the development of young people.



This three-pronged approach enables The Prudential Foundation to direct grants to organizations that share its commitment to improving the self-sufficiency of families and the future prospects of America's children.

We've made \$1 billion in social investments

Through our Social Investment Program, we build stronger communities by providing much-needed financing to organizations that improve access to affordable housing, community services, minority entrepreneurial opportunities and education. In 2004, the Social Investment Program provided nearly \$80 million in loans, helping to finance such projects as inner-city supermarkets, minority-owned businesses and charter schools in 500 cities and 40 states across the country.

Last year, the program celebrated a historic milestone: \$1 billion in cumulative investments addressing critical social issues, making the program one of the largest of its type in the United States.

32,500 employees and friends turn out to lend a hand

Prudential donates more than just money to communities. For 10 years, our employees around the world have put their commitment to volunteerism into action during our annual Prudential Global Volunteer Day. On October 2, 2004, more than 32,500 employees, their family members and friends participated in 1,057 projects in all 50 states and 16 other countries.

We encourage our employees to give back to their communities year-round. Through our Personal Volunteer Day program, employees are able to take one paid day off each year to volunteer with a charitable organization that is personally meaningful to them. In all, our employees donated more than 242,000 volunteer hours in 2004, further demonstrating their commitment to supporting the communities where we live and work.

We've honored 55,000 young volunteers

For the last decade, we have encouraged today's youth to volunteer their time and talents to help revitalize their communities through The Prudential Spirit of Community Awards. Created in partnership with the National Association of Secondary School Principals, the program recognizes students in grades 5 through 12 for their exemplary commitment to volunteer service.

Since its inception, the program has honored more than 55,000 school-age children at the local, state and national levels for making a difference in their communities, has become the United States' largest youth recognition program based solely on volunteer service, and has expanded to Japan, Korea and Taiwan.

Our business is global, but our philanthropic efforts show that Prudential's roots are deeply embedded in local communities. ●

We're among *Fortune's* 50 Best Companies for Minorities

At Prudential, we recognize that each of our employees brings a unique set of talents and insights to work. The combination of these diverse perspectives and strengths gives us a competitive advantage.

We're committed to encouraging diversity in every aspect of our operations, because we know that to win in the global marketplace, we must win in the workplace. By fostering a work environment where diversity is valued and innovation applauded, we'll continue to attract and retain talented individuals who will help us deliver the quality financial services the global marketplace demands and the results our shareholders expect.

In 2004, our efforts to promote diversity in our work force were once again recognized.

Most Admired Companies

Insurance, Life and Health category
Fortune

America's 50 Best Companies for Minorities

Fortune

Top 10 Companies for Working Mothers

Working Mother

Top 100 Companies for Providing Opportunities for Hispanics

Hispanic Magazine

Great Places to Work for Women of Color

Essence

Top 50 Employers

Careers & the disAbled Magazine

Top 10 Companies for Executive Women

National Association for Female Executives

Top 50 Companies for Diversity

DiversityInc.

50 Best Companies for Latinas to Work for in the U.S.

Latina Style

100 Percent Score on the Corporate Equality Index

Human Rights Campaign

Prudential Officers and Directors

Executive Officers

Arthur F. Ryan
Chairman, Chief Executive
Officer and President

Vivian Banta
Vice Chairman
Insurance Division

Mark B. Grier
Vice Chairman
Financial Management

Rodger A. Lawson
Vice Chairman
International Insurance and
Investments Division

John R. Strangfeld Jr.
Vice Chairman
Investment Division

Robert C. Golden
Executive Vice President
Operations and Systems

Richard J. Carbone
Senior Vice President and
Chief Financial Officer

John M. Liftin
Senior Vice President and
General Counsel

Sharon C. Taylor
Senior Vice President
Human Resources

Board of Directors

Frederic K. Becker
President, Wilentz,
Goldman & Spitzer, P.A.

Gordon M. Bethune
(effective 2/1/05)
Former Chairman and
Chief Executive Officer
Continental Airlines, Inc.

Gaston Caperton
President, The College
Board

Gilbert F. Casellas
Attorney and Former
Chairman, U.S. Equal
Employment Opportunity
Commission

James G. Cullen
Retired President and
Chief Operating Officer
Bell Atlantic Corporation

William H. Gray III
Retired President and
Chief Executive Officer
The College Fund/UNCF

Jon F. Hanson
Chairman, The
Hampshire Companies

Glen H. Hiner
Former Chairman and
Chief Executive Officer
Owens Corning

Constance J. Horner
Guest Scholar, The
Brookings Institution

Karl J. Krapek
Retired President and Chief
Operating Officer, United
Technologies Corporation

Arthur F. Ryan
Chairman of the Board,
CEO and President
Prudential Financial, Inc.

Ida F. S. Schmertz
Founder and Chair
Microleasing LLC

James A. Unruh
Founding Principal, Alerion
Capital Group, L.L.C.

(1) We measure this goal based on after-tax adjusted operating income and attributed equity of our Financial Services Businesses. Adjusted operating income, which is not measured in accordance with generally accepted accounting principles (GAAP), excludes net realized investment gains and losses, other than those associated with terminating hedges of foreign currency earnings and current period yield adjustments. A significant element of realized losses is impairments and losses from sales of credit-impaired securities, the timing of which depends largely on market credit cycles and can vary considerably across periods. The timing of other sales that would result in gains or losses is largely subject to our discretion and influenced by market opportunities. 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 inure to contractholders. Trends in the underlying profitability of our businesses can be more clearly identified without the fluctuating effects of these transactions. Adjusted operating income also excludes the results of divested businesses, which are not relevant to our ongoing operations, and certain other items, described elsewhere herein. Because we do not predict future realized investment gains (losses) or recorded changes in asset and liability values that will ultimately inure to contractholders, we cannot provide a measure of our goal based on income from continuing operations of the Financial Services Businesses, which is the GAAP measure most comparable to adjusted operating income.

Some of the statements included in this Annual Report may contain forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. Please see page 176 for a description of certain risks and uncertainties that could cause actual results to differ, possibly materially, from expectations or estimates reflected in such forward-looking statements.

All facts and figures as of December 31, 2004, unless otherwise noted.

“Prudential Financial”®, “The Rock”®, **Prudential Financial**® and “Growing and Protecting Your Wealth”® are registered service marks of The Prudential Insurance Company of America.

Prudential Real Estate brokerage services are offered by the franchisees of Prudential Real Estate Affiliates, Inc. Most franchises are independently owned and operated. Equal Housing Opportunity.

Securities products offered by Pruco Securities, LLC, Prudential Investment Management Services, LLC, American Skandia Marketing, Incorporated and Prudential Equity Group (all members SIPC).

Insurance issued by The Prudential Insurance Company of America, Pruco Life Insurance Company (in New York by Pruco Life Insurance Company of New Jersey), Prudential Retirement Insurance and Annuity Company and American Skandia Life Assurance Corporation.

All are Prudential Financial companies, and each is responsible for its own financial condition and contractual obligations.

Financial Section



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Throughout this Annual Report, "Prudential Financial" refers 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.

Financial Services Businesses and Closed Block Business

Effective with the date of demutualization, we established the Financial Services Businesses and the Closed Block Business. The Financial Services Businesses refer to the businesses in our three operating divisions 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. The Common Stock reflects the performance of the Financial Services Businesses, but there can be no assurance that the market value of the Common Stock will reflect solely the financial performance of these businesses. The Class B Stock, which was issued in a private placement on the date of the demutualization, reflects the financial performance of the Closed Block Business, as defined in Note 20 to the Consolidated Financial Statements.

We allocate all of our assets, liabilities and earnings between the Financial Services Businesses and Closed Block Business as if they were separate legal entities, but there is no legal separation between these two businesses. Holders of both the Common Stock and the Class B Stock are common stockholders of Prudential Financial and, as such, are subject to all the risks associated with an investment in Prudential Financial and all of its businesses. The Common Stock and the Class B Stock will be entitled to dividends, if and when declared by Prudential Financial's Board of Directors from funds legally available to pay them, as if the businesses were separate legal entities. See Note 13 to the Consolidated Financial Statements for a discussion of liquidation rights of the Common Stock and the Class B Stock, dividend restrictions on the Common Stock if we do not pay dividends on the Class B Stock when there are funds legally available to pay them and conversion rights of the Class B Stock.

SELECTED FINANCIAL DATA

We derived the selected consolidated income statement data for the years ended December 31, 2004, 2003 and 2002 and the selected consolidated balance sheet data as of December 31, 2004 and 2003 from our Consolidated Financial Statements included elsewhere herein. We derived the selected consolidated income statement data for the years ended December 31, 2001 and 2000 and the selected consolidated balance sheet data as of December 31, 2002, 2001 and 2000 from consolidated financial statements not included herein.

On April 1, 2004, we acquired the retirement business of CIGNA Corporation. Results for 2004 include results of that business from the date of acquisition.

On May 1, 2003, we acquired Skandia U.S. Inc., which included American Skandia, Inc. Results presented below include results of American Skandia from the date of acquisition.

On July 1, 2003, we completed an agreement with Wachovia Corporation, or Wachovia, to combine each company's respective retail securities brokerage and clearing operations forming a joint venture, Wachovia Securities. 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; periods prior to July 1, 2003, continue to reflect the results of our previously wholly owned securities brokerage operations on a fully consolidated basis. Accordingly, operating results for 2004 reflect earnings from the joint venture on the equity basis. Results for 2003 reflect our securities brokerage operations on a consolidated basis for the first six months of 2003 and earnings from the joint venture on the equity basis for the remaining six month period. Results for 2002 and prior years reflect our securities brokerage operations on a fully consolidated basis.

In April 2001, we acquired Gibraltar Life, which has adopted a November 30 fiscal year end. Consolidated balance sheet data as of December 31, 2004, 2003, 2002 and 2001 includes Gibraltar Life assets and liabilities as of November 30 and fully consolidated income statement data for 2001 includes Gibraltar Life results from April 2, 2001, the date of its reorganization, through November 30, 2001. Consolidated income statement data for 2004, 2003 and 2002 includes Gibraltar Life results for the twelve months ended November 30, 2004, 2003 and 2002, respectively.

We have made several dispositions that materially affect the comparability of the data presented below. In the fourth quarter of 2003, we completed the sale of our property and casualty insurance companies that operated nationally in 48 states outside of New Jersey, and the District of Columbia, to Liberty Mutual Group, as well as our New Jersey property and casualty insurance companies to Palisades Group. Results for 2003 include a pre-tax loss of \$491 million related to the disposition of these businesses. In the fourth quarter of 2000, we terminated the capital markets activities of Prudential Securities. This business had a pre-tax loss of \$22 million in 2004, pre-tax income of \$287 million in 2003, including the gain from a \$332 million settlement of an arbitration award, a pre-tax loss of \$36 million in 2002, a pre-tax loss of \$159 million in 2001 and a pre-tax loss of \$620 million in 2000. The loss from these operations in 2000 included charges of \$476 million associated with our termination and wind-down of these businesses. In 2000, we sold Gibraltar Casualty Company, a commercial property and casualty insurer that we placed in wind-down status in 1985. We incurred losses of \$81 million in 2003 and \$79 million in 2002 under a stop-loss agreement we entered into at the time of sale. Gibraltar Casualty had no impact on results in 2001 and incurred pre-tax losses of \$6 million in 2000.

On December 18, 2001, Prudential Insurance converted from a mutual life insurance company owned by its policyholders to a stock life insurance company and became an indirect, wholly owned subsidiary of Prudential Financial. "Demutualization costs and expenses" amounted to \$588 million in 2001 and \$143 million in 2000. "Demutualization costs and expenses" in 2001 include \$340 million of demutualization consideration paid to former Canadian branch policyholders.

You should read this selected consolidated financial information in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our Consolidated Financial Statements included elsewhere herein.

Year Ended December 31,

	2004	2003	2002	2001	2000
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(in millions, except per share and ratio information)

Income Statement Data:

Revenues:					
Premiums	\$ 12,580	\$ 13,233	\$ 13,053	\$ 11,904	\$ 9,966
Policy charges and fee income	2,317	2,001	1,780	2,027	1,639
Net investment income	9,079	8,680	8,818	9,085	9,417
Realized investment gains (losses), net	726	270	(1,365)	(674)	(265)
Commissions and other income	3,646	3,704	3,992	4,304	5,239
Total revenues	28,348	27,888	26,278	26,646	25,996
Benefits and expenses:					
Policyholders' benefits	12,896	13,424	13,378	12,457	10,473
Interest credited to policyholders' account balances	2,334	1,830	1,846	1,804	1,751
Dividends to policyholders	2,485	2,602	2,644	2,722	2,724
General and administrative expenses	7,346	7,562	8,328	9,200	9,754
Capital markets restructuring	—	—	—	—	476
Loss on disposition of property and casualty insurance operations	—	491	—	—	—
Demutualization costs and expenses	—	—	—	588	143
Total benefits and expenses	25,061	25,909	26,196	26,771	25,321
Income (loss) from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change	3,287	1,979	82	(125)	675
Income tax expense (benefit)	955	657	(188)	(33)	381
Income (loss) from continuing operations before extraordinary gain on acquisition and cumulative effect of accounting change	2,332	1,322	270	(92)	294
Income (loss) from discontinued operations, net of taxes	(18)	(58)	(76)	(62)	104
Extraordinary gain on acquisition, net of taxes	21	—	—	—	—
Cumulative effect of accounting change, net of taxes	(79)	—	—	—	—
Net income (loss)	\$ 2,256	\$ 1,264	\$ 194	\$ (154)	\$ 398
Basic income from continuing operations before extraordinary gain on acquisition and cumulative effect of accounting change per share—Common Stock(1)	\$ 3.52	\$ 2.10	\$ 1.38	\$ 0.07	
Diluted income from continuing operations before extraordinary gain on acquisition and cumulative effect of accounting change per share—Common Stock(1)	\$ 3.45	\$ 2.08	\$ 1.38	\$ 0.07	
Basic net income per share—Common Stock(1)	\$ 3.38	\$ 1.99	\$ 1.25	\$ 0.07	
Diluted net income per share—Common Stock(1)	\$ 3.31	\$ 1.98	\$ 1.25	\$ 0.07	
Basic and diluted net income (loss) per share—Class B Stock(1)	\$ 249.00	\$ 89.50	\$ (264.00)	\$ 1.50	
Dividends declared per share—Common Stock	\$ 0.625	\$ 0.50	\$ 0.40		
Dividends declared per share—Class B Stock	\$ 9.625	\$ 9.625	\$ 9.625		
Ratio of earnings to fixed charges(2)	2.07	1.80	1.05		1.22

	As of December 31,				
	2004	2003	2002	2001	2000
	(in millions)				
Balance Sheet Data:					
Total investments excluding policy loans	\$208,251	\$172,889	\$174,381	\$157,400	\$140,588
Separate account assets	115,568	106,680	70,555	77,158	82,217
Total assets	401,058	321,274	292,616	292,901	272,619
Future policy benefits, policyholders' account balances and unpaid claims and claim adjustment expenses	179,337	146,223	140,168	133,732	104,130
Separate account liabilities	115,568	106,680	70,555	77,158	82,217
Short-term debt	4,044	4,739	3,469	5,405	11,131
Long-term debt	7,627	5,610	4,757	5,304	2,502
Total liabilities	378,714	299,982	270,596	271,758	252,011
Guaranteed beneficial interest in Trust holding solely debentures of Parent(3)	—	—	690	690	—
Equity	22,344	21,292	21,330	20,453	20,608

- (1) Earnings per share data for 2001 reflects earnings for the period from December 18, 2001, the date of demutualization, through December 31, 2001 only.
- (2) For purposes of this computation, earnings are defined as income from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change excluding undistributed income from equity method investments, fixed charges and interest capitalized. Fixed charges are the sum of gross interest expense, interest credited to policyholders' account balances and an estimated interest component of rent expense. Due to the Company's loss in 2001, the ratio coverage was less than 1:1 and is therefore not presented. Additional earnings of \$160 million would have been required in 2001 to achieve a ratio of 1:1.
- (3) Effective December 31, 2003, the Company adopted the revised guidance under FIN No. 46. As a result, the Trust was deconsolidated and the Prudential Financial debentures are reported as "Long-term debt."

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following analysis of our consolidated financial condition and results of operations in conjunction with the "Forward-Looking Statements," "Selected Financial Data" and the "Consolidated Financial Statements" included in this Annual Report.

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. In the first quarter of 2004, we combined the former Other Asset Management segment with the former Investment Management segment to form the Asset Management segment. 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 domestic in force participating products were segregated, together with assets, in a regulatory mechanism referred to as the "Closed Block." The Closed Block is designed generally to provide for the reasonable expectations for future policy dividends after demutualization of holders of participating individual life insurance policies and annuities included in the Closed Block by allocating assets that will be used exclusively for payment of benefits, including policyholder dividends, expenses and taxes with respect to these products. See Note 9 to the Consolidated Financial Statements for more information on the Closed Block. We selected the amount of Closed Block assets so that the Closed Block assets initially had a lower book value than the Closed Block liabilities. We expect that the Closed Block assets will generate sufficient cash flow, together with anticipated revenues from the Closed Block policies, over the life of the Closed Block to fund payments of all expenses, taxes, and policyholder benefits to be paid to, and the reasonable dividend expectations of, holders of the Closed Block policies. We also segregated for accounting purposes the assets that we need to hold outside the Closed Block to meet capital requirements related to the Closed Block policies. No policies sold after demutualization will be added to the Closed Block, and its in force business is expected to ultimately decline as we pay policyholder benefits in full. We also expect the proportion of our business represented by the Closed Block to decline as we grow other businesses.

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

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

Revenues and Expenses

We earn our revenues principally from insurance premiums; mortality, expense, and asset management fees from insurance and investment products; and investment of general account and other funds. We earn premiums primarily from the sale of individual life insurance and group life and disability insurance. We earn mortality, expense, and asset management fees from the sale and servicing of separate account products including variable life insurance and variable annuities. We also earn asset management and administrative fees from the distribution, servicing and management of mutual funds, retirement products and other asset management products and services. Our operating expenses principally consist of insurance benefits provided, general business expenses, dividends to policyholders, commissions and other costs of selling and servicing the various products we sell and interest credited on general account liabilities.

Profitability

Our profitability depends principally on our ability to price and manage risk on insurance products, our ability to attract and retain customer assets and our ability to manage expenses. Specific drivers of our profitability include:

- our ability to manufacture and distribute products and services and to introduce new products that gain market acceptance on a timely basis;
- our ability to price our insurance products at a level that enables us to earn a margin over the cost of providing benefits and the expense of acquiring customers and administering those products;
- our mortality and morbidity experience on individual and group life insurance, annuity and group disability insurance products;
- our persistency experience, which affects our ability to recover the cost of acquiring new business over the lives of the contracts;
- our cost of administering insurance contracts and providing asset management products and services;
- our returns on invested assets, net of the amounts we credit to policyholders' accounts;
- our ability to earn commissions and fees from the distribution and servicing of mutual funds, annuities, retirement products, and other investment products at a level that enables us to earn a margin over the expense of providing such services;
- the performance of our investment in Wachovia Securities Financial Holdings, LLC, or Wachovia Securities;
- the amount of our assets under management and changes in their fair value, which affect the amount of asset management fees we receive;
- our ability to generate favorable investment results through asset/liability management and strategic and tactical asset allocation; and
- our ability to maintain our credit and financial strength ratings.

In addition, factors such as regulation, competition, interest rates, taxes, foreign exchange rates, securities market conditions and general economic conditions affect our profitability. In some of our product lines, particularly those in the Closed Block Business, we share experience on mortality, morbidity, persistency and investment results with our customers, which can offset the impact of these factors on our profitability from those products.

Historically, the participating products included in the Closed Block have yielded lower returns on capital invested than many of our other businesses. As we have ceased offering domestic participating products, we expect that the proportion of the traditional participating products in our in force business will gradually diminish as these older policies age, and we grow other businesses. However, the relatively lower returns to us on this existing block of business will continue to affect our consolidated results of operations for many years. Our Common Stock reflects the performance of our Financial Services Businesses, but there can be no assurance that the market value of the Common Stock will reflect solely the performance of these businesses.

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, securities brokerage. We offer these products and services through one of the largest distribution networks in the financial services industry.

Significant developments and events in 2004 reflect our continued efforts to redeploy capital effectively to seek enhanced returns. These developments included:

- The acquisition, on April 1, 2004, of the retirement business of CIGNA Corporation for cash consideration of \$2.1 billion.
- The continuation of our share repurchase program. In 2004, we repurchased 32.5 million shares of Common Stock at a total cost of \$1.5 billion and are authorized, under a new stock repurchase program authorized by Prudential Financial's Board of Directors in November 2004, to repurchase up to an additional \$1.5 billion of Common Stock during 2005.
- A 25% increase in our annual Common Stock dividend, to \$0.625 per share.
- The acquisition, on February 27, 2004, of an 80% interest in Hyundai Investment and Securities Co., Ltd. and its subsidiary Hyundai Investment Trust Management Co., Ltd., which we refer to together as Hyundai, a Korean asset management firm, subsequently renamed Prudential Investment & Securities Co., Ltd.

On February 19, 2004, A.M. Best Company upgraded the financial strength ratings of Prudential Insurance and our domestic insurance operations to "A+" (Superior) from "A" (Excellent). On October 13, 2004, Moody's Investors Service, Inc. upgraded the financial strength rating of Prudential Insurance to "Aa3" (Excellent) from "A1" (Good). On November 30, 2004, Standard & Poor's Rating Services upgraded the financial strength ratings of Prudential Insurance and our domestic insurance operations to "AA-" (Very Strong) from "A+" (Strong). These ratings are of concern to policyholders, agents and intermediaries. They are not directed toward stockholders and do not in any way reflect evaluations of the safety and security of the Common Stock.

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.

Shown below are the contributions of each segment to our adjusted operating income for the years ended December 31, 2004, 2003 and 2002 and a reconciliation of adjusted operating income of our segments to income from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change.

	Year ended December 31,		
	2004	2003	2002
	(in millions)		
Adjusted operating income before income taxes for segments of the Financial Services Businesses:			
Individual Life and Annuities	\$ 817	\$ 619	\$ 390
Group Insurance	174	169	155
Asset Management	266	208	184
Financial Advisory	(245)	(111)	(43)
Retirement	334	192	141
International Insurance	917	819	757
International Investments	86	(10)	—
Corporate and Other	158	88	156
Items excluded from adjusted operating income:			
Realized investment gains (losses), net, and related adjustments	82	(156)	(872)
Charges related to realized investment gains (losses), net	(58)	(43)	6
Investment gains (losses) on trading account assets supporting insurance liabilities, net	(43)	—	—
Change in experience-rated contractholder liabilities due to asset value changes	(11)	—	—
Sales practices remedies and costs	—	—	(20)
Divested businesses	(105)	(166)	(15)
Income from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change for Financial Services Businesses	2,372	1,609	839
Income (loss) from continuing operations before income taxes for Closed Block Business	915	370	(757)
Consolidated income from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change	<u>\$3,287</u>	<u>\$1,979</u>	<u>\$ 82</u>

Results for 2004 presented above reflect the following:

- Continued strong performance of our international insurance operations, including pre-tax adjusted operating income of \$402 million from our Gibraltar Life operations, and pre-tax adjusted operating income of \$515 million from our international insurance operations other than Gibraltar Life.
- Significantly improved results of our Individual Life and Annuities segment reflecting a \$33 million improvement from 2003 in our individual life business and a \$165 million improvement from 2003 in our annuities business. Results of the annuity business we acquired from American Skandia contributed \$242 million of pre-tax adjusted operating income in 2004 and \$167 million in 2003, which represented the initial eight months of results from that business following the May 2003 acquisition. Pre-tax adjusted operating income from our original individual annuity

business, excluding American Skandia, increased \$90 million from 2003, as the business benefited from higher asset based fees and increased net interest spread on general account annuities.

- Improved results of our Retirement segment reflecting \$128 million in pre-tax adjusted operating income in 2004 from the retirement business acquired from CIGNA on April 1, 2004. Pre-tax adjusted operating income from our original retirement business of \$206 million in 2004, reflected improved results from our defined contribution business, partially offset by a decline in adjusted operating income from our guaranteed products business.
- Improved results of our Asset Management segment, which benefited from increased asset-based fees, primarily as a result of increases in assets under management due to the acquisition of CIGNA's retirement business, market appreciation and positive net inflows.
- Continued strong results from our Group Insurance segment, which contributed pre-tax adjusted operating income of \$174 million in 2004.
- Improved results from our International Investments segment, which benefited from our February 2004 acquisition of an 80% stake in Hyundai Investment and Securities Co., Ltd., a Korean asset management firm.
- Losses, on a pre-tax adjusted operating income basis, of \$245 million in 2004 from our Financial Advisory segment. Our 38% share of earnings from our Wachovia Securities joint venture, before transition costs, contributed pre-tax adjusted operating income of \$172 million in 2004. However, the segment's results included transition costs of \$194 million. The segment's losses also included costs of \$227 million for 2004 related to obligations we retained in connection with the businesses we contributed to the joint venture, primarily retained litigation and regulatory matters.
- Realized investment gains (losses), net, and related charges and adjustments for the Financial Services Businesses in 2004 included impairments and credit-related losses of \$143 million, down from \$404 million in 2003.
- Results of the Closed Block Business for 2004 included realized investment gains of \$715 million in 2004, compared to \$426 million in 2003.

Accounting Policies & Pronouncements

Application of Critical Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America, or GAAP, requires the application of accounting policies that often involve a significant degree of judgment. Management, on an ongoing basis, reviews estimates and assumptions used in the preparation of financial statements. If management determines that modifications in assumptions and estimates are appropriate given current facts and circumstances, results of operations and financial position as reported in the Consolidated Financial Statements could change significantly.

The following sections discuss the accounting policies applied in preparing our financial statements that management believes are most dependent on the application of estimates and assumptions.

Valuation of Investments

As prescribed by GAAP, we present our investments classified as available for sale, including fixed maturity and equity securities, and our investments classified as trading, such as our trading account assets supporting insurance liabilities, at fair value in the statements of financial position. The fair values for our public fixed maturity securities and our public equity securities are based on quoted market prices or estimates from independent pricing services. However, for our investments in private securities such as private placement fixed maturity securities, which comprise 14% of our investments as of December 31, 2004, this information is not available. For these private fixed maturities, fair value is determined typically by using a discounted cash flow model, which considers current market credit spreads for publicly traded issues with similar terms by companies of comparable credit quality, and an additional spread component for the reduced liquidity associated with private placements. This additional spread component is determined based on surveys of various third party financial institutions. See “—Realized Investment Gains and General Account Investments—General Account Investments—Fixed Maturity Securities—Private Fixed Maturities—Credit Quality” for information regarding the credit quality of the private fixed maturity securities included in our general account.

For our investments classified as available for sale, the impact of changes in fair value is recorded as an unrealized gain or loss in “Accumulated other comprehensive income (loss), net,” a separate component of equity. For our investments

classified as trading, the impact of changes in fair value is recorded within “Commissions and other income.” In addition, investments classified as available for sale, as well as those classified as held to maturity, are subject to impairment reviews to identify when a decline in value is other than temporary. Factors we consider in determining whether a decline in value is other than temporary include: the extent (generally if greater than 20%) and duration (generally if greater than six months) of the decline; the reasons for the decline in value (credit event or interest rate related); our ability and intent to hold the investment for a period of time that will allow for a recovery of value; and the financial condition and near-term prospects of the issuer. When it is determined that a decline in value is other than temporary, the carrying value of the security is reduced to its fair value, with a corresponding charge to earnings. This corresponding charge is referred to as an impairment and is reflected in “Realized investment gains (losses), net” in the statements of operations. The level of impairment losses can be expected to increase when economic conditions worsen and decrease when economic conditions improve. See “—Realized Investment Gains and General Account Investments—Realized Investment Gains” for a discussion of the effects of impairments on our operating results for the years ended December 31, 2004, 2003 and 2002.

Commercial loans, which comprise 11% of our investments as of December 31, 2004, are carried primarily at unpaid principal balances, net of unamortized discounts and an allowance for losses. This allowance includes a loan specific portion as well as a portfolio reserve for probable incurred but not specifically identified losses. The loan specific portion is based on management’s judgment as to ultimate collectibility of loan principal. The portfolio reserve is based on a number of factors, such as historical experience and portfolio diversification. Adjustments to the allowance are reflected in “Realized investment gains (losses), net,” in our statements of operations. Similar to impairment losses discussed above, the allowance for losses can be expected to increase when economic conditions worsen and decrease when economic conditions improve. See “—Realized Investment Gains and General Account Investments—General Account Investments—Commercial Loans—Commercial Loan Quality” for a discussion of the effects of the valuation allowance on our operating results for the years ended December 31, 2004 and 2003.

See “—Realized Investment Gains and General Account Investments—General Account Investments” for a discussion of our investment portfolio, including the gross unrealized gains and losses as of December 31, 2004, related to the fixed maturity and equity securities of our general account, our policies and procedures regarding the identification of other than temporary declines in investment value, and the carrying value, credit quality, and allowance for losses related to the commercial loans of our general account.

Policyholder Liabilities

Future Policy Benefit Reserves

We establish reserves for future policy benefits to or on behalf of policyholders in the same period in which the policy is issued. These reserves relate primarily to the traditional participating whole life policies of our Closed Block Business and the non-participating whole life, term life, group disability insurance and group pension and structured settlement products of our Financial Services Businesses.

The future policy benefit reserves for the traditional participating life insurance products of our Closed Block Business, which as of December 31, 2004, represented 48% of our total future policy benefit reserves, are determined using the net level premium method as prescribed by GAAP. In applying this method, we use mortality assumptions to determine our expected future benefits and expected future premiums, and apply an interest rate to determine the present value of both the expected future benefit payments and the expected future premiums. The mortality assumptions we used were based on data from the standard industry experience studies that were used to determine the cash surrender value of the policies and the interest rates used are the contractually guaranteed interest rates used to calculate the cash surrender value of the policy. Gains or losses in our results of operations for each period resulting from deviations in actual experience compared to the experience assumed in establishing our reserves for this business are included in the determination of our annual dividends to these policyholders. Given our current level of policy dividends, we do not anticipate significant volatility in our results of operations in future periods as a result of these deviations.

The future policy benefit reserves for our International Insurance segment and our domestic individual life business, which as of December 31, 2004, represented 35% of our total future policy benefit reserves combined, relate primarily to non-participating whole life and term life products and are determined in accordance with GAAP as the present value of expected future benefits to or on behalf of policyholders plus the present value of future expenses less the present value of future net premiums. The expected future benefits and expenses are based on mortality, lapse, maintenance expense, and interest rate assumptions. Reserves for new business are based on best estimate assumptions as of the date the policy is issued with provisions for the risk of adverse deviation. After our reserves are initially established, we perform premium deficiency tests using best estimate assumptions as of the testing date without provisions for adverse deviation. If reserves determined

based on these assumptions are greater than the existing reserves, the existing reserves are adjusted to the greater amount. Our mortality assumptions are generally based on the Company's historical experience or standard industry tables, as applicable; our expense assumptions are based on current levels of maintenance costs, adjusted for the effects of inflation; and our interest rate assumptions are based on current and expected net investment returns. We review our mortality assumptions annually and conduct full actuarial studies every three years. Generally, we do not expect our mortality trends to change significantly in the short-term and to the extent these trends may change we expect such changes to be gradual over the long-term.

The reserves for future policy benefits of our Retirement segment, which as of December 31, 2004 represented 13% of our total future policy benefit reserves, relate primarily to our group pension and structured settlement products. These reserves are generally determined as the present value of expected future benefits and expenses based on mortality, retirement, maintenance expense, and interest rate assumptions. Reserves for new business are based on best estimate assumptions as of the date the contract is issued with provisions for the risk of adverse deviation. After our reserves are initially established, we perform premium deficiency testing by product group using best estimate assumptions as of the testing date without provisions for adverse deviation. If reserves determined based on these assumptions are greater than the existing reserves, the existing reserves are adjusted to the greater amount. Our best estimate assumptions are determined by product group. Our mortality and retirement assumptions are based on Company experience; our expense assumptions are based on current levels of maintenance costs, adjusted for the effects of inflation; and our interest rate assumptions are based on current and expected net investment returns.

Unpaid claims and claim adjustment expenses

Our liability for unpaid claims and claim adjustment expenses relates primarily to the group long-term disability products of our Group Insurance segment. This liability represents our estimate of future expenses and disability claim payments as well as estimates of claims that we believe have been incurred, but have not yet been reported as of the balance sheet date. We do not establish loss liabilities until a loss has occurred. As prescribed by GAAP, our liability is determined as the present value of future claim payments and expenses. Future claims payments are estimated using assumed mortality and claim termination factors and an assumed interest rate. The mortality and claim termination factors are based on standard industry tables and Company experience. Our interest rate assumptions are based on factors such as market conditions and expected investment returns. Of these assumptions, our claim termination assumptions have historically had the most significant effects on our level of liability. We regularly review our claim termination assumptions compared to actual terminations and conduct full actuarial studies every two to three years. These studies review actual claim termination experience over a number of years with more weight placed on the actual experience in the more recent years. If actual experience results in a materially different assumption, we adjust our liability for unpaid claims and claims adjustment expenses accordingly with a charge or credit to current period earnings. Generally, we do not expect our actual claim termination experience to deviate significantly from the experience we assumed in determining our level of liability.

Deferred Policy Acquisition Costs

We capitalize costs that vary with and are related primarily to the acquisition of new and renewal insurance and annuity contracts. These costs include primarily commissions, costs of policy issuance and underwriting, and variable field office expenses. We amortize these deferred policy acquisition costs, or DAC, over the expected lives of the contracts, based on the level and timing of either gross margins, gross profits, or gross premiums, depending on the type of contract. As of December 31, 2004, DAC in our Financial Services Businesses was \$7.6 billion and DAC in our Closed Block Business was \$1.2 billion.

DAC associated with the traditional participating products of our Closed Block Business is amortized over the expected lives of those contracts in proportion to gross margins. Gross margins consider premiums, investment returns, benefit claims, costs for policy administration, changes in reserves, and dividends to policyholders. We evaluate our estimates of future gross margins and adjust the related DAC balance with a corresponding charge or credit to current period earnings for the effects of actual gross margins and changes in our expected future gross margins. Since many of the factors that affect gross margins are included in the determination of our dividends to these policyholders, we do not anticipate significant volatility in our results of operations as a result of DAC adjustments, given our current level of dividends.

DAC associated with the term life policies of our domestic individual life insurance business and the non-participating whole life, term life and health policies of our international insurance businesses is amortized in proportion to gross premiums. We evaluate the recoverability of our DAC related to these policies as part of our premium deficiency testing. If a premium deficiency exists, we reduce DAC by the amount of the deficiency or to zero through a charge to current period earnings. If the deficiency is more than the DAC balance, we then increase the reserve for future policy benefits by the excess by means of a charge to current period earnings. Generally, we do not expect significant short-term deterioration in experience, and therefore do not expect significant writedowns of the related DAC.

DAC associated with the variable and universal life policies of our domestic individual life insurance and international insurance businesses and the variable and fixed annuity contracts of our individual annuities business is amortized over the expected life of these policies in proportion to gross profits. In calculating gross profits, we consider mortality, persistency, and other elements as well as rates of return on investments associated with these contracts. We regularly evaluate and adjust the related DAC balance with a corresponding charge or credit to current period earnings for the effects of our actual gross profits and changes in our assumptions regarding estimated future gross profits. Our evaluation of DAC related to variable annuity contracts considers expected gross profits that would be generated within a pre-established reasonably possible range, or corridor, of future rate of return scenarios. Adjustments to DAC are made only when our long-term view of investment returns considered in our estimates of future gross profits results in a DAC balance outside of the corridor. However, notwithstanding our corridor approach, we may determine that a revision of our expected gross profits and a related adjustment to our DAC is necessary if changes in additional factors, such as policyholder activity, suggest that our current view of expected gross profits may no longer represent our best estimate. For variable annuity contracts, DAC is more sensitive to the effects of changes in our estimates of gross profits due primarily to the significant portion of gross profits that is dependent upon the total rate of return on assets held in separate account investment options, and the shorter average life of the contracts. This rate of return influences the fees we earn, costs we incur associated with minimum death benefit and other contractual guarantees specific to our variable annuity contracts, as well as other sources of profit. This is also true, to a lesser degree, for our variable life policies; however, the variable life policies derive a significant portion of their gross profits from margins in the cost of insurance charge.

In evaluating the DAC for our domestic variable life insurance and annuity products, future rate of return assumptions are evaluated using a reversion to mean approach, a common industry practice. Under this approach, we consider actual returns over a period of time and project returns for the future period so that the assets grow at the expected rate of return for the entire period. If the projected future rate of return is greater than our maximum future rate of return, we use our maximum reasonable future rate of return. For variable annuities products, our expected rate of return is 8% per annum, which reflects an expected rate of return of 8.9% per annum for equity type assets. The future equity rate of return used varies by product, but was under 8.9% per annum for all of our variable annuity products for our evaluation of deferred policy acquisition costs as of December 31, 2004.

To demonstrate the sensitivity of our variable annuity DAC balance relative to our future rate of return, increasing or decreasing our future rate of return by 100 basis points would have required us to consider adjustments, subject to our application of the corridor approach, to that DAC balance as follows. The information provided in the table below considers only the effect of changes in our future rate of return and not changes in any other assumptions such as persistency, mortality, or expenses included in our evaluation of DAC.

	Increase/(Reduction) in DAC
	(in millions)
Increase in future rate of return by 100 basis points	\$ 18
Decrease in future rate of return by 100 basis points	\$(18)

For a discussion of DAC adjustments related to our individual annuities business for the years ended December 31, 2004, 2003 and 2002, see “—Results of Operations for Financial Services Businesses by Segment—Insurance Division—Individual Life and Annuities.”

Goodwill

We test goodwill for impairment on an annual basis as of December 31 of each year and more frequently if events occur or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Impairment testing requires us to compare the fair value of each reporting unit to its carrying amount, including goodwill, and record an impairment charge if the carrying amount of a reporting unit exceeds its estimated fair value. The determination of a reporting unit’s fair value is based on management’s best estimate, which generally considers the unit’s expected future earnings and market-based earning multiples of peer companies. As of December 31, 2004, we have \$976 million of goodwill reflected on our statements of financial position. During 2004, we recorded a goodwill impairment of \$53 million relating to our Dryden Wealth Management business and, during 2002, we recorded goodwill impairments of \$36 million relating primarily to our property and casualty business. There were no goodwill impairment charges during 2003.

Pension and Other Postretirement Benefits

We sponsor pension and other postretirement benefit plans covering employees who meet specific eligibility requirements. Our net periodic costs for these plans consider an assumed interest rate, an expected rate of return on plan

assets and expected increases in compensation levels and trends in health care costs. Of these assumptions, our expected rate of return assumptions have historically had the most significant effect on our net period costs associated with these plans. We determine our expected return on plan assets based upon the arithmetical average of prospective returns, which is based upon a risk free rate as of the measurement date adjusted by a risk premium that considers historical statistics and expected investment manager performance, for equity, debt and real estate markets applied on a weighted average basis to our asset portfolio. See Note 16 to our Consolidated Financial Statements for our actual asset allocations by asset category and the asset allocation ranges prescribed by our investment policy guidelines for both our pension and other post-retirement benefit plans. Our assumed long-term rate of return for 2004 was 8.75% for our pension plan and 7.75% for our other post retirement benefit plans. Given the amount of plan assets as of September 30, 2003, the beginning of the measurement year, if we had assumed an expected rate of return for both our pension and other postretirement benefit plans that was 1 percentage point lower or 1 percentage point higher than the rates we assumed, the change in our net periodic costs would have been as shown in the table below. The information provided in the table below considers only changes in our assumed long-term rate of return given the level and mix of invested assets at the beginning of the measurement year, without consideration of possible changes in any of the other assumptions described above that could ultimately accompany any changes in our assumed long-term rate of return.

For the year ended December 31, 2004		
	Increase/(decrease) in Net Periodic Pension Benefit	Increase/(decrease) in Net Periodic Other Postretirement Benefit Cost
	(in millions)	
Increase in expected rate of return by 1 percentage point	\$ 94	\$ 10
Decrease in expected rate of return by 1 percentage point	\$(94)	\$(10)

For a discussion of our expected rate of return on plan assets for 2005 see “—Results of Operations for Financial Services Businesses by Segment—Corporate and Other Operations.”

In addition to the effect of changes in our assumptions, our net periodic pension benefit and our net periodic cost for other postretirement benefits may change due to factors such as actual experience being different from our assumptions, special benefits to terminated employees, or changes in benefits provided under the plans.

Taxes on Income

Our effective tax rate is based on expected income and statutory tax rates and tax planning opportunities available in the various jurisdictions in which we operate. Inherent in determining our annual tax rate are judgments regarding business plans, planning opportunities and expectations about future outcomes.

Tax regulations require items to be included in the tax return at different times from the items are reflected in the financial statements. As a result, the effective tax rate reflected in the financial statements is different than the actual rate applied on the tax return. Some of these differences are permanent such as expenses that are not deductible in our tax return, and some differences are temporary, reversing over time, such as valuation of insurance reserves. Timing differences create deferred tax assets and liabilities. Deferred tax assets generally represent items that can be used as a tax deduction or credit in future years for which we have already recorded the tax benefit in our income statement. Deferred tax liabilities generally represent tax expense recognized in our financial statements for which payment has been deferred, or expenditures for which we have already taken a deduction in our tax return but have not yet recognized in our financial statements. The application of GAAP requires us to evaluate the recoverability of our deferred tax assets and establish a valuation allowance if necessary to reduce our deferred tax asset to an amount that is more likely than not to be realized. Realization of certain deferred tax assets is dependent upon generating sufficient taxable income in the appropriate jurisdiction prior to the expiration of the carry-forward periods. Although realization is not assured, management believes it is more likely than not the deferred tax assets, net of valuation allowances, will be realized.

Our accounting represents management’s best estimate of future events that can be appropriately reflected in the accounting estimates. Certain changes or future events, such as changes in tax legislation, geographic mix of earnings and completion of tax audits could have an impact on our estimates and effective tax rate.

To the extent our effective tax rate increases or decreases by 1 percent of income from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change, consolidated income from continuing operations before extraordinary gain on acquisition and cumulative effect of accounting change would have increased or declined by \$33 million in 2004.

The amount of income taxes paid by the Company is subject to ongoing audits in various jurisdictions. We reserve for our best estimate of potential payments/settlements to be made to the Internal Revenue Service and other taxing jurisdictions for audits ongoing or not yet commenced. We anticipate that the Internal Revenue Service will complete its examination of 1997 through 2001 during the first half of 2005. Although the results of these audits are not final, based on currently available information, we believe that the outcome will not have an adverse effect on our financial position, cash flows or results of operations.

Reserves for Contingencies

A contingency is an existing condition that involves a degree of uncertainty that will ultimately be resolved upon the occurrence of future events. Under GAAP, reserves for contingencies are required to be established when the future event is probable and its impact can be reasonably estimated. An example is the establishment of a reserve for losses in connection with an unresolved legal matter. The initial reserve reflects management's best estimate of the probable cost of ultimate resolution of the matter and is revised accordingly as facts and circumstances change and, ultimately, when the matter is brought to closure.

Accounting Policies Adopted

Accounting for Stock Options

Employee stock options issued during 2001 and 2002 are accounted for using the intrinsic value method prescribed by Accounting Principles Board, or APB, No. 25, "Accounting to Stock Issued to Employees," and related interpretations, an allowable alternative method under Statement of Financial Accounting Standards, or SFAS, No. 123, "Accounting for Stock-Based Compensation." Under APB No. 25, we did not recognize any stock-based compensation expense for employee stock options as all employee stock options had an exercise price equal to the market value of our Common Stock at the date of grant. Effective January 1, 2003, we changed our accounting for employee stock options to adopt the fair value recognition provisions of SFAS No. 123, as amended, prospectively for all new awards granted to employees on or after January 1, 2003. Under these provisions, the fair value of all employee stock options awarded on or after January 1, 2003, is included in the determination of net income, but not for options awarded prior thereto. Accordingly, the amount we include in the determination of net income is less than that which would have been recognized if the fair value method had been applied to all awards since inception of the employee stock option plan. The fair value of employee stock options issued prior to January 1, 2003 was estimated using a Black-Scholes option-pricing model. For options issued on or after January 1, 2003, the fair value of each option was estimated using a binomial option-pricing model. Both option-pricing models consider the following assumptions in estimating fair value: dividend yield, expected volatility, risk-free interest rate, and expected life of the option. If we had recognized stock option expense for all employee stock options under the fair value based accounting method, net income of the Financial Services Businesses for the year ended December 31, 2004, would have been reduced by \$26 million or, \$0.05 per share of Common Stock on a both basic and diluted basis. The net income of the Closed Block Business for the year ended December 31, 2004, would have been reduced by \$1 million with no change in earnings per share of the Class B Stock. For the year ended December 31, 2003, net income would have been reduced by \$35 million or \$0.06 and \$0.07 per share of Common Stock on a basic and diluted basis, respectively. The net income of the Closed Block Business for the year ended December 31, 2003, would have been reduced by \$1 million with no change in earnings per share of the Class B Stock. For the year ended December 31, 2002, net income and basic and diluted earnings per share of Common Stock would have been reduced by \$30 million and \$0.05, respectively.

Accounting for Certain Nontraditional Long-Duration Contracts and for Separate Accounts

See Note 2 to the Consolidated Financial Statements for a discussion of the cumulative effect of accounting change from the adoption of Statement of Position 03-1, "Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts" or, SOP 03-1, which became effective on January 1, 2004.

Recent Accounting Pronouncements

See Note 2 to the Consolidated Financial Statements for a discussion of the recently issued final standard on accounting for share-based payments, FASB Statement No. 123R (revised 2004), "Share-Based Payment," which we will implement effective July 1, 2005.

Consolidated Results of Operations

The following table summarizes income from continuing operations before extraordinary gain on acquisition and cumulative effect of accounting change for the Financial Services Businesses and the Closed Block Business as well as other components comprising net income.

	Year ended December 31,		
	2004	2003	2002
	(in millions)		
Financial Services Businesses by segment:			
Individual Life and Annuities	\$ 804	\$ 565	\$ 243
Group Insurance	217	117	26
Total Insurance Division	1,021	682	269
Asset Management	274	213	248
Financial Advisory	(245)	(111)	(43)
Retirement	345	196	(235)
Total Investment Division	374	298	(30)
International Insurance	920	805	569
International Investments	38	(62)	—
Total International Insurance and Investments Division	958	743	569
Corporate and Other	19	(114)	31
Income from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change for Financial Services Businesses	2,372	1,609	839
Income (loss) from continuing operations before income taxes for Closed Block Business	915	370	(757)
Income (loss) from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change	3,287	1,979	82
Income tax expense (benefit)	955	657	(188)
Income from continuing operations before extraordinary gain on acquisition and cumulative effect of accounting change	2,332	1,322	270
Loss from discontinued operations, net of taxes	(18)	(58)	(76)
Extraordinary gain on acquisition, net of taxes	21	—	—
Cumulative effect of accounting change, net of taxes	(79)	—	—
Net income	<u>\$2,256</u>	<u>\$1,264</u>	<u>\$ 194</u>

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 GAAP. Adjusted operating income does not equate to "income from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change" as determined in accordance with 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, extraordinary gain on acquisition and cumulative effect of accounting change" to exclude the following items:

- realized investment gains net of losses, 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;
- life insurance sales practices remedies and costs; 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 GAAP.

We include in adjusted operating income the portion of our realized investment gains and losses on derivatives that arises 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 gains and losses on derivatives used to manage interest rate and currency exposure on asset and liability mismatches that represents current period yield adjustments for these assets and liabilities.

The contributions to income/loss of wind-down businesses that we have not divested remain in adjusted operating income.

The excluded items are important to an understanding of our overall results of operations. Adjusted operating income is not a substitute for net income determined in accordance with 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 net realized investment gains and losses, other than those associated with terminating hedges of foreign currency earnings and current period yield adjustments. A significant element of realized investment losses is impairments and losses from sales of credit-impaired securities, the timing of which depends largely on market credit cycles and can vary considerably across periods. The timing of other sales that would result in gains or losses is largely subject to our discretion and influenced by market opportunities. 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 inure to the contractholders. Adjusted operating income also excludes life insurance sales practices remedies and costs relating to the settlement of individual life insurance sales practices issues for the period from 1982 through 1995 because they relate to a substantial and identifiable non-recurring event. Adjusted operating income excludes the results of divested businesses because they are not relevant to understanding our ongoing operating results. See Note 20 to the Consolidated Financial Statements for further information on the presentation of segment results.

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.

	Year ended December 31,		
	2004	2003	2002
	(in millions)		
Operating results:			
Revenues:			
Individual Life	\$2,125	\$1,936	\$1,952
Individual Annuities	1,578	1,146	744
	<u>3,703</u>	<u>3,082</u>	<u>2,696</u>
Benefits and expenses:			
Individual Life	1,735	1,579	1,520
Individual Annuities	1,151	884	786
	<u>2,886</u>	<u>2,463</u>	<u>2,306</u>
Adjusted operating income:			
Individual Life	390	357	432
Individual Annuities	427	262	(42)
	<u>817</u>	<u>619</u>	<u>390</u>
Realized investment gains (losses), net, and related adjustments(1)	21	(41)	(162)
Related charges(1)(2)	(34)	(13)	15
Income from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change	<u>\$ 804</u>	<u>\$ 565</u>	<u>\$ 243</u>

- (1) Revenues exclude realized investment gains (losses), net, and related charges and adjustments. The related charges represent payments related to the market value adjustment features of certain of our annuity products. For a discussion of these items 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. For a discussion of these items see "—Realized Investment Gains and General Account Investments—Realized Investment Gains."

On May 1, 2003, we acquired Skandia U.S. Inc., which included American Skandia, Inc., for a total purchase price of \$1.184 billion. Beginning May 1, 2003, the results of American Skandia have been included in our consolidated results and are included as a component of our annuity business discussed below.

Adjusted Operating Income

2004 to 2003 Annual Comparison. The segment's individual life business adjusted operating income increased \$33 million, from \$357 million in 2003 to \$390 million in 2004. The increase reflected more favorable claims experience, net of reinsurance, in 2004. However, results for 2004 reflect a lower contribution from investment income after investment related expenses in comparison to 2003, due to a decrease in the level of capital required to support the business. The decrease in the level of capital required to support the business reflected changes in statutory reserving requirements for certain products and certain reinsurance arrangements we initiated. Results for 2004 also include a decline in recovery of costs of our agency distribution system associated with the distribution of property and casualty insurance products, due to our sale of the property and casualty business in late 2003.

Results of the segment's individual annuity business for 2004 included adjusted operating income of \$242 million from the operations of American Skandia, compared to \$167 million in 2003, which included the results of these operations for only the last eight months of the year. Adjusted operating income of \$242 million for 2004 consisted of revenues of \$741 million and total benefits and expenses of \$499 million. American Skandia's revenues in 2004 consisted primarily of policy charges and fee income of \$413 million, asset management and service fees of \$212 million and net investment income of \$91 million. Benefits and expenses consisted primarily of general and administrative expenses of \$297 million, including \$30 million from the amortization of the value of business acquired asset established when the company was acquired, interest credited to policyholder account balances of \$80 million and policyholder benefits, including related change in reserves, of \$93 million.

Adjusted operating income of the segment's individual annuity business, excluding American Skandia, increased \$90 million, from \$95 million in 2003 to \$185 million in 2004. The increase in adjusted operating income came primarily from improved net interest spread on our general account annuities reflecting improved investment yields, reductions of credited interest rates effective as of January 1, 2004, as well as higher asset balances, and higher fees resulting from greater variable annuity account values. Increased amortization of deferred policy acquisition costs reflecting the higher level of gross profits partially offset the foregoing factors. Adjusted operating income for 2004 and 2003 included reductions in amortization of deferred policy acquisition costs of \$44 million and \$39 million, respectively, due to our increased estimate of future gross profits on variable annuities reflecting market value increases in underlying assets as well as continued favorable mortality and lapse experience, which amount for 2003 was largely offset by a \$36 million charge to strengthen reserves for our periodic income annuities.

2003 to 2002 Annual Comparison. The segment's individual life business adjusted operating income decreased \$75 million, from \$432 million in 2002 to \$357 million in 2003. The decline was primarily the result of claims experience, net of reinsurance, less favorable than in the prior year, partially offset by the favorable impact of increases in the market value of variable life insurance assets.

Results of the segment's individual annuity business for 2003 included adjusted operating income of \$167 million from the initial eight months of our ownership of the operations of American Skandia, which consisted of revenues of \$416 million and total benefits and expenses of \$249 million. American Skandia's revenues consisted primarily of policy charges and fee income of \$242 million and asset management and service fees of \$126 million. Benefits and expenses consisted primarily of general and administrative expenses of \$200 million, including \$38 million of amortization of the value of business acquired asset established when the company was acquired and \$35 million of guaranteed minimum death benefit payments.

Adjusted operating income of the segment's individual annuity business, excluding American Skandia, increased \$137 million, from a loss, on an adjusted operating income basis, of \$42 million in 2002 to income of \$95 million in 2003. Adjusted operating income for 2003 included a \$39 million reduction in amortization of deferred policy acquisition costs due to our increased estimate of future gross profits on variable annuities reflecting market value increases in underlying assets. This benefit to adjusted operating income was largely offset by a \$36 million charge to strengthen reserves for our periodic income annuities. Results for 2002 included charges totaling \$137 million for additional amortization of deferred policy acquisition costs, reflecting our lower estimates of future gross profits resulting from greater expected costs from minimum death benefit guarantees and lower expected fees under individual annuity contracts due to declines in asset values.

Revenues

2004 to 2003 Annual Comparison. The segment's individual life insurance business reported revenues, as shown in the table above under "—Operating Results," of \$2.125 billion in 2004, compared to \$1.936 billion in 2003. Commissions and other income increased \$141 million, primarily reflecting an increase in revenue from the distribution of property and casualty insurance products by our agents, which was more than offset by a related increase in operating expenses, including agent commissions. Premiums increased \$23 million, primarily due to increased premiums on term life insurance reflecting growth of our in force block of term insurance products.

Revenues from the segment's individual annuity business increased \$432 million, from \$1.146 billion in 2003 to \$1.578 billion in 2004, which included increased revenues of \$325 million from American Skandia. Revenues of the segment's individual annuity business, excluding American Skandia, increased \$107 million, from \$730 million in 2003 to \$837 million in 2004, due primarily to a \$71 million increase in net investment income, reflecting a higher level of invested assets, as well as increased yields. In addition, policy charges and fees increased \$36 million, reflecting an increase in the average market value of variable annuity customer accounts.

2003 to 2002 Annual Comparison. The segment's individual life insurance business revenues decreased \$16 million, from \$1.952 billion in 2002 to \$1.936 billion 2003. Premiums decreased \$43 million, from \$395 million in 2002 to \$352 million in 2003, reflecting approximately \$80 million in decreased premiums on term insurance we issued under policy provisions to customers who previously had lapsing variable life insurance policies with us, partially offset by increased sales and growth of our in force block of term insurance products.

Revenues from the segment's individual annuity business increased \$402 million, from \$744 million in 2002 to \$1.146 billion in 2003, which included revenues of \$416 million from American Skandia. Revenues of the segment's individual annuity business, excluding American Skandia, declined \$14 million, from \$744 million in 2002 to \$730 million in 2003, due primarily to an \$18 million decrease in policy charges and fees as, despite a year to year increase, the average market value of variable annuity customer accounts declined in 2003 from 2002.

Benefits and Expenses

2004 to 2003 Annual Comparison. Benefits and expenses, as shown in the table above under "—Operating Results," of the segment's individual life insurance business increased \$156 million, from \$1.579 billion in 2003 to \$1.735 billion in 2004. The increase reflects a \$176 million increase in operating expenses, including costs related to the distribution of property and casualty insurance products discussed above. Amortization of deferred policy acquisition costs increased \$79 million from 2003 to 2004, reflecting a lower level of amortization in the prior year due to the strong equity market performance and less favorable mortality experience in 2003. Partially offsetting these items was a decline in policyholder benefits and related changes in reserves of \$130 million, from \$773 million in 2003 to \$643 million in 2004, primarily due to claims experience, net of reinsurance, being at a more favorable level than in the prior year.

Benefits and expenses of the segment's individual annuity business increased \$267 million, from \$884 million in 2003 to \$1.151 billion in 2004, which included increased benefits and expenses of \$250 million related to American Skandia. Benefits and expenses of the segment's individual annuity business, excluding American Skandia, increased \$17 million, from \$635 million in 2003 to \$652 million in 2004. Amortization of deferred policy acquisition costs increased \$52 million, primarily as a result of a higher level of gross profits in the current period. Partially offsetting this was the impact of a \$36 million charge to strengthen reserves for our periodic income annuities in 2003.

2003 to 2002 Annual Comparison. Benefits and expenses of the segment's individual life insurance business increased \$59 million, from \$1.520 billion in 2002 to \$1.579 billion in 2003. The increase reflects a \$97 million increase in policyholder benefits and related changes in reserves, from \$676 million in 2002 to \$773 million in 2003, as well as an increase in employee termination and related costs. The increase in policyholder benefits and related changes in reserves came primarily from claims experience, net of reinsurance, less favorable than the prior year, partially offset by decreased policy reserves on term insurance, corresponding to the decreased premiums discussed above. Partially offsetting these increases was a decrease in amortization of deferred policy acquisition costs, due primarily to less favorable claims experience and lower policy surrenders.

Benefits and expenses of the segment's individual annuity business increased \$98 million, from \$786 million in 2002 to \$884 million in 2003, which included \$249 million of expenses related to American Skandia. Benefits and expenses of the segment's individual annuity business, excluding American Skandia, decreased \$151 million, from \$786 million in 2002 to \$635 million in 2003. Amortization of deferred policy acquisition costs declined \$178 million from 2002 to 2003, primarily as a result of the changes in our estimated future gross profits as discussed above. Partially offsetting this was a \$28 million increase in policyholder benefits and related change in reserves, reflecting the \$36 million charge to strengthen reserves for our periodic income annuities discussed above, which resulted from refinements in our calculation of these reserves. Benefits and expenses of our individual annuity business include \$69 million of guaranteed minimum death benefits in 2003 of which \$35 million is associated with the American Skandia business.

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 changes in account

value for the individual annuity business, for the periods indicated. Sales of the individual life insurance business do not correspond to revenues under 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.

	Year ended December 31,		
	2004	2003	2002
	(in millions)		
Life insurance sales(1):			
Excluding corporate-owned life insurance:			
Variable life	\$ 97	\$ 99	\$ 145
Universal life	178	132	86
Term life	116	110	89
Total excluding corporate-owned life insurance	391	341	320
Corporate-owned life insurance	14	21	122
Total	<u>\$ 405</u>	<u>\$ 362</u>	<u>\$ 442</u>
Life Insurance sales by distribution channel(1):			
Prudential Agents(2)	\$ 236	\$ 230	\$ 238
Third party(2)	155	111	82
Corporate-owned life insurance	14	21	122
Total	<u>\$ 405</u>	<u>\$ 362</u>	<u>\$ 442</u>
Variable Annuities(3):			
Beginning total account value	\$43,949	\$15,338	\$18,689
Sales	5,806	4,418	1,395
Surrenders and withdrawals	(5,224)	(3,716)	(2,031)
Net sales (redemptions)	582	702	(636)
Benefit payments	(613)	(449)	(273)
Net flows	(31)	253	(909)
Change in market value, interest credited and other activity	4,091	6,329	(2,255)
Policy charges	(591)	(402)	(187)
Acquisition of American Skandia	—	22,431	—
Ending total account value	<u>\$47,418</u>	<u>\$43,949</u>	<u>\$15,338</u>
Fixed Annuities:			
Beginning total account value	\$ 3,514	\$ 3,396	\$ 2,975
Sales	532	247	605
Surrenders and withdrawals	(191)	(141)	(143)
Net sales	341	106	462
Benefit payments	(163)	(162)	(145)
Net flows	178	(56)	317
Interest credited and other activity	191	178	107
Policy charges	(4)	(4)	(3)
Ending total account value	<u>\$ 3,879</u>	<u>\$ 3,514</u>	<u>\$ 3,396</u>

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

(2) Excluding corporate-owned life insurance.

(3) Variable annuities include only those sold as retail investment products. Investments through defined contribution plan products are included with such products.

2004 to 2003 Annual Comparison. Sales of new life insurance, excluding corporate-owned life insurance, measured as described above, increased \$50 million from 2003 to 2004. Sales of our universal life products, which were updated as to features and pricing in June 2003, increased \$46 million.

Sales by Prudential Agents increased \$6 million from 2003 to 2004, reflecting an increase in agent productivity that more than offset a decline in the average number of agents from approximately 4,300 in 2003 to approximately 4,000 in 2004. Sales by the third party distribution channel, excluding corporate-owned life insurance, increased \$44 million from 2003 to 2004, reflecting increased universal and term life sales through this distribution channel.

Total account values for fixed and variable annuities amounted to \$51.3 billion as of December 31, 2004, an increase of \$3.8 billion from December 31, 2003. The increase came primarily from increases in the market value of customers' variable annuities, as well as net sales of \$923 million. Individual variable annuity gross sales increased by \$1.4 billion, from \$4.4 billion in 2003 to \$5.8 billion in 2004, reflecting the inclusion of variable annuity sales from American Skandia for only the last eight months of 2003. Fixed annuities gross sales increased by \$285 million from 2003 to 2004, reflecting a new product introduced in 2004. Surrenders and withdrawals increased \$1.6 billion from 2003 to 2004, reflecting the additional period of activity from American Skandia, as well as the impact of higher average account values.

2003 to 2002 Annual Comparison. Sales of new life insurance excluding corporate-owned life insurance, measured as described above, increased \$21 million from 2002 to 2003. Sales of our universal life and term life products, both of which were updated as to features and pricing in 2003, increased \$46 million and \$21 million, respectively. These increases were offset by a decline of \$46 million in variable life sales, which were negatively affected by customer response to prolonged volatile equity market conditions. Sales of corporate-owned life insurance, substantially all of which is sold by the third-party distribution channel, declined by \$101 million. The decline reflects primarily a single large sale in 2002.

Sales from Prudential Agents decreased slightly from 2002 to 2003, reflecting a decline in the average number of agents for the period from approximately 4,500 in 2002 to approximately 4,300 in 2003 due to selective hiring of new agents and closures of several offices to promote the cost effectiveness of the Prudential Agent distribution channel as well as some attrition of agents resulting from the Company's sale of its property and casualty insurance businesses in 2003. Sales by the third party distribution channel, other than corporate-owned life insurance, increased \$29 million from 2002 to 2003, reflecting increased universal and term life sales through this channel.

Total account values for fixed and variable annuities amounted to \$47.5 billion as of December 31, 2003, an increase of \$28.7 billion, which included \$22.4 billion from the May 1, 2003 acquisition of American Skandia. The remainder of the increase came primarily from increases in the market value of customers' variable annuities as well as net sales of \$808 million. Individual variable annuity gross sales increased by \$3.0 billion, from \$1.4 billion for 2002 to \$4.4 billion for 2003, primarily due to \$2.5 billion in variable annuity sales contributed by American Skandia from the date of acquisition. Excluding American Skandia, variable annuity gross sales increased by \$528 million, driven by improving market conditions, product enhancements, and continued expansion in third party distribution. Sales of fixed annuities declined year-over-year by \$358 million, due primarily to management's decision to lower crediting rates in the current interest rate environment. Surrenders and withdrawals increased \$1.7 billion in 2003 from 2002, including \$2.1 billion from American Skandia, reflecting the larger base of business.

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 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.

	Year ended December 31,		
	2004	2003	2002
	(in millions)		
Cash value of surrenders	<u>\$633</u>	<u>\$653</u>	<u>\$692</u>
Cash value of surrenders as a percentage of mean future benefit reserves, policyholders' account balances, and separate account balances	<u>3.3%</u>	<u>3.8%</u>	<u>4.2%</u>

2004 to 2003 Annual Comparison. The total cash value of surrenders decreased \$20 million, from \$653 million in 2003 to \$633 million in 2004. The level of surrenders as a percentage of mean future policy benefit reserves, policyholders' account balances and separate account balances decreased from 2003 to 2004, reflecting a lower level of surrenders in 2004 associated with increases in variable life insurance account values due to market performance.

2003 to 2002 Annual Comparison. The total cash value of surrenders decreased \$39 million, from \$692 million in 2002 to \$653 million in 2003. The level of surrenders as a percentage of mean future policy benefit reserves, policyholders' account balances and separate account balances decreased from 2002 to 2003, reflecting a higher level of lapses in 2002 associated with declines in variable life insurance account values due to adverse equity market conditions.

Group Insurance

Operating Results

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

	Year ended December 31,		
	2004	2003	2002
	(in millions)		
Operating results:			
Revenues	\$3,867	\$3,690	\$3,586
Benefits and expenses	3,693	3,521	3,431
Adjusted operating income	174	169	155
Realized investment gains (losses), net, and related adjustments(1)	43	(52)	(129)
Income (loss) from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change	\$ 217	\$ 117	\$ 26

(1) Revenues exclude realized investment gains (losses), net, and related adjustments. For a discussion of these items see "—Realized Investment Gains and General Account Investments—Realized Investment Gains."

Adjusted Operating Income

2004 to 2003 Annual Comparison. Adjusted operating income increased \$5 million, from \$169 million in 2003 to \$174 million in 2004. Adjusted operating income for 2003 included a net favorable effect of \$8 million from refinements in group life reserves for waiver of premium features and estimates of amounts due policyholders on experience rated cases. Excluding these items, adjusted operating income increased \$13 million primarily due to more favorable mortality experience in our group life insurance business which was partially offset by less favorable claims experience in our group disability business and costs related to legal and regulatory matters that were incurred during 2004.

2003 to 2002 Annual Comparison. Adjusted operating income increased \$14 million, from \$155 in 2002 to \$169 million in 2003. Adjusted operating income for 2003 included a net favorable effect of \$8 million from refinements in group life reserves for waiver of premium features and estimates of amounts due policyholders on experience rated cases, as discussed above, while 2002 benefited \$19 million from refinements in reserves relating to our group long-term disability product. Excluding the \$11 million net negative impact of these refinements, adjusted operating income increased \$25 million in 2003 from 2002, reflecting more favorable group life benefits experience in 2003 and a greater contribution from investment results.

Revenues

2004 to 2003 Annual Comparison. Revenues, as shown in the table above under "—Operating Results," increased by \$177 million, from \$3.690 billion in 2003 to \$3.867 billion in 2004. Group life insurance premiums increased by \$73 million to \$2.249 billion, primarily due to growth in business in force resulting from new sales and continued strong persistency, which improved slightly from 93% in 2003 to 94% in 2004. Group disability premiums, which include long-term care products, increased by \$46 million to \$676 million, also reflecting growth in business in force resulting from new sales and continued strong persistency, which improved slightly from 85% in 2003 to 86% in 2004. The increase in premiums also reflects the negative effect in 2003 of a \$9 million increase in our estimate of amounts due policyholders on experience rated cases, as discussed above. Policy charges and fee income increased by \$80 million, which includes the negative effect in 2003 of a \$17 million increase in our estimate of amounts due policyholders on experience rated cases, as discussed above. Excluding the effect of this refinement, policy charges and fee income increased by \$63 million, primarily reflecting higher charges and fees on experienced rated contracts sold to employers for funding of employee benefit programs and retirement arrangements. Partially offsetting these increases was a decrease in net investment income of \$24 million, due primarily to a decrease in income from policyholder loans. The decrease in income from policyholder loans reflects reductions in the balances of these loans, which also results in a corresponding decline in interest credited to policyholders' account balances.

2003 to 2002 Annual Comparison. Revenues increased by \$104 million, from \$3.586 billion in 2002 to \$3.690 billion in 2003. Group life insurance premiums increased by \$81 million to \$2.176 billion primarily due to growth in business in force resulting from new sales and continued strong persistency, which declined slightly from 95% in 2002 to 93% in 2003. Group disability premiums, which include long-term care products, increased by \$56 million to \$630 million reflecting the

growth in business in force resulting from new sales and continued strong persistency, which decreased slightly from 87% in 2002 to 85% in 2003. These increases in premiums were partially offset by a \$9 million increase in our estimate of amounts due policyholders on experience rated cases, as discussed above. Policy charges and fee income declined by \$42 million primarily as a result of a \$17 million increase in our estimate of amounts due policyholders on experience rated cases, as discussed above, and lower fees on experience rated contracts sold to employers for funding of employee benefit programs and retirement arrangements. Although net investment income was relatively unchanged in 2003 from 2002, the portion of this income from policyholder loans declined, with a corresponding decline in interest credited to policyholders' account balances, which resulted in a greater contribution from investment results to adjusted operating income in 2003, as the remaining base of invested assets increased.

Benefits and Expenses

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

	Year ended December 31,		
	2004	2003	2002
Benefits ratio(1):			
Group life	88.4%	90.9%	91.7%
Group disability	94.6	92.4	87.9
Administrative operating expense ratio(2):			
Group life	10.9	9.7	10.0
Group disability	22.1	22.5	22.0

(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.

2004 to 2003 Annual Comparison. Benefits and expenses, as shown in the table above under "—Operating Results," increased by \$172 million, from \$3.521 billion in 2003 to \$3.693 billion in 2004. The increase was primarily driven by an increase of \$133 million in policyholders' benefits, including the change in policy reserves, which reflects a \$34 million reduction in benefits in 2003 due to refinements in group life reserves for waiver of premium features, as discussed above, the unfavorable effect of an increase in the group disability benefits ratio and the growth of business in force. Also contributing to the increase in benefits and expenses was an increase of \$63 million in operating expenses as a result of growth in the business, premium taxes associated with the increased revenues related to contracts for funding of employee benefit and retirement programs, and costs related to legal and regulatory matters that were incurred during 2004. Partially offsetting the increases in benefits and expenses was a \$31 million decrease in interest credited to policyholders' account balances, primarily as a result of the decrease in outstanding policyholder loans discussed above.

The group life benefits ratio for 2004 decreased 2.5 percentage points from 2003, primarily reflecting more favorable claims experience. The group disability benefits ratio increased by 2.2 percentage points from 2003 to 2004 due to less favorable claims experience in our group disability business, primarily due to a decrease in net claim resolutions on our long-term disability products. In the later part of 2004, we expanded our claims resolution capacity for these products. The group life administrative operating expense ratio increased from 2003 to 2004 primarily due to the increases in premium taxes and legal and regulatory costs discussed above. The group disability administrative operating expense decreased slightly from 2003 to 2004.

2003 to 2002 Annual Comparison. Benefits and expenses increased by \$90 million, from \$3.431 billion in 2002 to \$3.521 billion in 2003. Benefits in 2003 were reduced \$34 million as a result of the refinements in group life reserves for waiver of premium features discussed above, while 2002 benefited \$19 million from reduction in benefits due to the refinement in reserves relating to our group long-term disability product. Excluding these items, benefits and expenses increased \$105 million. This increase resulted principally from an increase in policyholders' benefits, including change in policy reserves, reflecting the growth of business in force.

The group life benefits ratio for 2003 improved 0.8 percentage points from 2002 reflecting lower claims incidence. The group disability benefits ratio increased by 4.5 percentage points, of which 3.2 percentage points resulted from the reserve refinement in 2002 discussed above. The remaining 1.3 percentage point increase in the group disability benefits ratio is primarily due to a decrease in net claim resolutions on our long-term disability products, partially offset by favorable morbidity experience on our other disability products. The group life and disability administrative operating expense ratios remained relatively unchanged from 2002 to 2003.

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 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.

	Year ended December 31,		
	2004	2003	2002
	(in millions)		
New annualized premiums(1):			
Group life	\$237	\$225	\$269
Group disability(2)	161	144	160
Total	<u>\$398</u>	<u>\$369</u>	<u>\$429</u>

(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.

2004 to 2003 Annual Comparison. Total new annualized premiums increased \$29 million, or 8%, from 2003 to 2004. Group life sales increased in 2004 primarily due to an increase in sales in the large case market. Group disability sales increased in 2004 primarily due to additional sales to existing customers, mostly in the large case market.

2003 to 2002 Annual Comparison. Total new annualized premiums decreased \$60 million, or 14%, from 2002 to 2003. Group life sales decreased in 2003 due primarily to a smaller contribution from large case sales in 2003 as well as the expected slowing of our sales due to the implementation of pricing adjustments in 2002. Group disability sales decreased in 2003, primarily reflecting one large sale in the fourth quarter of 2002.

Investment Division

Asset Management

Operating Results

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

	Year ended December 31,		
	2004	2003	2002
	(in millions)		
Operating results:			
Revenues	\$1,464	\$1,360	\$1,325
Expenses	1,198	1,152	1,141
Adjusted operating income	266	208	184
Realized investment gains, net(1)	8	5	64
Income from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change	<u>\$ 274</u>	<u>\$ 213</u>	<u>\$ 248</u>

(1) Revenues exclude realized investment gains (losses), net. For a discussion of these items see "—Realized Investment Gains and General Account Investments—Realized Investment Gains."

Adjusted Operating Income

2004 to 2003 Annual Comparison. Adjusted operating income increased \$58 million, from \$208 million in 2003 to \$266 million in 2004, which includes \$31 million from the management of assets associated with the retirement business acquired from CIGNA. Results for 2004 benefited from higher asset-based fees in our investment management and advisory services reflecting market appreciation and positive net inflows, as well as improved results in our other asset management activities. Partially offsetting these items were charges in 2004 totaling \$28 million related to declines in value of intangible assets, expenses incurred in exiting an operating facility and termination of activities related to certain of our international investment management operations.

2003 to 2002 Annual Comparison. Adjusted operating income increased \$24 million, from \$184 million in 2002 to \$208 million in 2003. The increase reflected lower expenses, excluding the impact of recent acquisitions, and higher asset-based fees in our investment management and advisory operations, which were partially offset by a decline in retained fees as a result of the combination of our retail securities brokerage and clearing operations with those of Wachovia.

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 source and assets under management for the periods indicated. In managing our business we analyze assets under management, which do not correspond to GAAP assets, because our primary sources of revenues are fees based on assets under management.

	Year ended December 31,		
	2004	2003	2002
	(in millions)		
Revenues by source:			
Investment management and advisory services:			
Retail customers(1)	\$ 219	\$ 187	\$ 184
Institutional customers	442	372	335
General account	234	219	221
Sub-total	895	778	740
Mutual fund and other segment revenues(2)	569	582	585
Total revenues	\$1,464	\$1,360	\$1,325

- (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.
- (2) Represents mutual fund and other segment revenues other than asset management fees paid to affiliates, which are included in the appropriate categories above.

	<u>December 31, 2004</u>	<u>December 31, 2003</u>
	(in billions)	
Assets under management (at fair market value):		
Retail customers(1)	\$ 66.0	\$ 81.2
Institutional customers(2)	119.2	94.8
General account(3)	152.7	127.8
	<u> </u>	<u> </u>
Total investment management and advisory services	\$337.9	\$303.8

- (1) 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. Fixed annuities and the fixed rate options of both variable annuities and variable life insurance are included in the general account. Amount as of December 31, 2003 includes money market mutual fund balances of \$17.8 billion which, as of December 31, 2004, were essentially eliminated due to the replacement of these funds with other investment alternatives for brokerage clients of Wachovia Securities.
- (2) Consists of third party institutional assets and group insurance contracts. Amount as of December 31, 2004 includes assets associated with our acquisition of CIGNA's retirement business on April 1, 2004, which amounted to \$9.0 billion as of that date.
- (3) Amount as of December 31, 2004 includes assets associated with our acquisition of CIGNA's retirement business on April 1, 2004, which amounted to \$18.7 billion as of that date.

2004 to 2003 Annual Comparison. Revenues, as shown in the table above under "—Operating Results," increased \$104 million, from \$1.360 billion in 2003 to \$1.464 billion in 2004, due primarily to higher fees from the management of institutional and retail customer assets as a result of increased asset values primarily from market appreciation, assets associated with the retirement business acquired from CIGNA, an increase in transaction and performance based incentive fees related to real estate assets under management and increased revenues related to program services for certain mutual fund wrap and separately managed platforms of Wachovia Securities. Reduced income from our commercial mortgage operations, reflecting lower production volume and composition of originations, partially offset this increase. Revenues include asset management fees of \$28 million and \$79 million, for 2004 and 2003, respectively, associated with certain money market mutual fund balances of brokerage clients of Wachovia Securities. These balances were essentially eliminated as of September 30, 2004 due to the replacement of those funds with other investment alternatives for those brokerage clients. The resulting reduction in asset management fees has been offset by payments from Wachovia under an agreement dated as of July 30, 2004 implementing arrangements with respect to money market mutual funds in connection with the combination of our retail securities brokerage and clearing operations with those of Wachovia. The agreement extends for ten years after termination of the joint venture with Wachovia. The revenue from Wachovia under this agreement was \$35 million in 2004.

2003 to 2002 Annual Comparison. Revenues increased \$35 million, from \$1.325 billion in 2002 to \$1.360 billion in 2003. The increase came primarily from the management of institutional customer assets inclusive of revenues associated with an international real estate asset manager that we acquired at the end of 2002. A decline in mutual fund revenues from lower average account balances on which our fees are based was partially offset by the inclusion of revenues of the mutual fund business of American Skandia, commencing May 1, 2003.

Expenses

2004 to 2003 Annual Comparison. Expenses, as shown in the table above under “—Operating Results,” increased \$46 million, from \$1.152 billion in 2003 to \$1.198 billion in 2004, due primarily to higher incentive based compensation costs associated with increased revenues, as well as charges in 2004 related to declines in value of intangible assets, expenses incurred in exiting an operating facility and termination of activities related to certain of our international investment management operations.

2003 to 2002 Annual Comparison. Expenses increased \$11 million, from \$1.141 billion in 2002 to \$1.152 billion in 2003. Lower employee termination and facility consolidation costs in 2003, and lower asset based and other expenses in our mutual fund operations were offset by the inclusion of expenses associated with the mutual fund business of American Skandia commencing May 1, 2003 and an international real estate asset manager which we acquired at the end of 2002.

Financial Advisory

Operating Results

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

	Year ended December 31,		
	2004	2003	2002
	(in millions)		
Operating results:			
Revenues	\$ 318	\$1,306	\$2,421
Expenses	563	1,417	2,464
Adjusted operating income(1)	<u>\$(245)</u>	<u>\$ (111)</u>	<u>\$ (43)</u>

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

On July 1, 2003, we completed our previously announced agreement with Wachovia to combine each company’s respective retail securities brokerage and clearing operations, forming 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; periods prior to July 1, 2003 continue to reflect the results of our previously wholly owned securities brokerage operations on a fully consolidated basis. Accordingly “—Operating Results”, as shown above, presents our securities brokerage operations on a consolidated basis for 2002 and the first six months of 2003 and earnings from the joint venture on the equity basis for the remaining six months of 2003 and the year ended December 31, 2004.

2004 to 2003 Annual Comparison. The Financial Advisory segment reported a loss, on an adjusted operating income basis, of \$245 million in 2004. The segment’s loss for 2004 includes our share of earnings from Wachovia Securities of \$172 million, on a pre-tax basis and excluding transition costs. Offsetting these earnings were expenses of \$227 million relating primarily to obligations for litigation and regulatory matters we retained in connection with the contributed businesses. Our loss for 2004 also includes \$194 million of transition costs, of which \$114 million represents our share of costs incurred by the joint venture. Results for 2004 also include adjusted operating income of \$4 million from our equity sales and trading operations that were not contributed to the new entity.

In 2003, the segment reported a loss, on an adjusted operating income basis, of \$111 million. This loss includes a loss of \$53 million from our securities brokerage operations prior to combination of these operations with Wachovia on July 1, 2003. The segment’s loss for 2003 includes our share of earnings from Wachovia Securities, on a pre-tax basis and excluding transition costs, of \$88 million. Offsetting these results were expenses of \$107 million relating primarily to obligations for litigation and regulatory matters we retained in connection with the contributed businesses. Full year results from our

securities brokerage operations for 2003 include \$100 million of transition costs, of which \$32 million represents our share of costs incurred by the venture, as well as a pre-tax gain of \$22 million recorded on the completion of the combination of the businesses. In addition, results for 2003 include income of \$2 million from our equity sales and trading operations that were not contributed to the new entity.

2003 to 2002 Annual Comparison. The Financial Advisory segment reported a loss, on an adjusted operating income basis, of \$111 million in 2003, as discussed above.

In 2002 the segment reported a loss of \$43 million. The loss consisted of an \$87 million loss from our securities brokerage operations, which in 2003 were contributed to the joint venture, partially offset by income of \$44 million from our equity sales and trading operations.

Retirement

Operating Results

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

	Year ended December 31,		
	2004	2003	2002
	(in millions)		
Operating results:			
Revenues	\$3,225	\$2,281	\$2,375
Benefits and expenses	2,891	2,089	2,234
Adjusted operating income	334	192	141
Realized investment gains (losses), net, and related adjustments(1)	76	(1)	(383)
Related charges(2)	(11)	5	7
Investment gains (losses) on trading account assets supporting insurance liabilities, net(3)	(111)	—	—
Change in experience-rated contractholder liabilities due to asset value changes(4)	57	—	—
Income (loss) from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change	\$ 345	\$ 196	\$ (235)

- (1) Revenues exclude realized investment gains (losses), net, and related adjustments. For a discussion of these items 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 net realized investment gains (losses), net, on change in reserves and deferred policy acquisition cost amortization. For a discussion of these items see "—Realized Investment Gains and General Account Investments—Realized Investment Gains."
- (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."

On April 1, 2004, we completed the acquisition of the retirement business of CIGNA Corporation for cash consideration of \$2.1 billion. Beginning April 1, 2004, the results of the former CIGNA retirement business have been included in our consolidated results. The majority of these results are reflected within our Retirement segment, as discussed below, and the remaining portion is reflected in our Asset Management segment. See Note 3 to the Consolidated Financial Statements for further discussion of this acquisition and its purchase price allocation.

Adjusted Operating Income

2004 to 2003 Annual Comparison. Adjusted operating income increased \$142 million, from \$192 million in 2003 to \$334 million in 2004. Results for the segment include \$128 million of adjusted operating income from the inclusion of CIGNA's retirement business from the date of acquisition, which consisted of revenues of \$875 million and total benefits and expenses of \$747 million. Revenues from the acquired business consisted primarily of \$580 million in commissions and other income, comprised mainly of investment income related to trading account assets supporting insurance liabilities and asset management and service fees, and \$240 million in net investment income. Benefits and expenses from the acquired business consisted primarily of \$451 million of interest credited to policyholders' account balances and \$302 million of general and administrative expense. Transition costs related to the acquisition were \$43 million in 2004.

Adjusted operating income from the segment's original defined contribution business increased \$53 million, from a loss of \$1 million in 2003 to income of \$52 million in 2004, primarily reflecting lower crediting rates on general account

liabilities and higher asset management and service fees from a larger base of customer account values. Adjusted operating income from the segment's original guaranteed products business decreased \$39 million, from \$193 million in 2003 to \$154 million in 2004, primarily due to the benefit in the prior year from investment market value changes.

2003 to 2002 Annual Comparison. Adjusted operating income increased \$51 million, from \$141 million in 2002 to \$192 million in 2003. Our guaranteed products business reported adjusted operating income of \$193 million in 2003, an increase of \$28 million from 2002, reflecting more favorable investment results and lower operating expenses in 2003, partially offset by an \$18 million decrease in income from prepayments of investments. The remainder of the increase in adjusted operating income came from the segment's defined contribution business, which also benefited from more favorable investment results and lower operating expenses in 2003.

Revenues

2004 to 2003 Annual Comparison. Revenues, as shown in the table above under "—Operating Results," increased \$944 million, from \$2.281 billion in 2003 to \$3.225 billion in 2004 and include \$875 million of revenue in 2004 from the business acquired from CIGNA, as discussed above. Revenue for the segment's original businesses, excluding the business acquired from CIGNA, increased by \$69 million. Premiums increased \$62 million, primarily due to an increase in sales of structured settlements following the upgrade of Prudential Insurance's financial strength rating by A.M. Best during 2004. Commissions and other income increased \$24 million as a result of growth in customer account values. Partially offsetting these increases was a decrease in net investment income as the prior period benefited from investment market value changes.

2003 to 2002 Annual Comparison. Revenues decreased \$94 million, from \$2.375 billion in 2002 to \$2.281 billion in 2003. Net investment income decreased \$47 million due primarily to an \$18 million decrease in income from prepayments of investments and a decline in yields resulting from the reinvestment of assets in a lower interest rate environment. Premiums decreased \$48 million in our guaranteed products business primarily as a result of lower single premium annuity and structured settlement product sales.

Benefits and Expenses

2004 to 2003 Annual Comparison. Benefits and expenses, as shown in the table above under "—Operating Results," increased \$802 million, from \$2.089 billion in 2003 to \$2.891 billion in 2004 and include \$747 million of benefits and expenses in 2004 from the business acquired from CIGNA, as discussed above. Benefits and expenses for the segment's original businesses, excluding the business acquired from CIGNA, increased by \$55 million. The increase in benefits and expenses is primarily due to a \$68 million increase in policyholders' benefits, including the change in policy reserves, reflecting the increase in premiums discussed above, partially offset by lower crediting rates on general account liabilities.

2003 to 2002 Annual Comparison. Benefits and expenses decreased \$145 million, from \$2.234 billion in 2002 to \$2.089 billion in 2003. Policyholders' benefits, together with the change in policy reserves and interest credited to policyholders, decreased \$121 million due to the decrease in premium activity noted above, as well as more favorable investment results in 2003 and lower crediting rates on general account liabilities. Operating expenses decreased \$16 million from 2002 to 2003 reflecting cost reduction measures implemented in prior periods.

Sales Results and Account Values

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

	Year ended December 31,		
	2004	2003	2002
	(in millions)		
Defined Contribution:			
Beginning total account value	\$ 28,658	\$22,914	\$24,640
Sales	8,890	5,179	3,858
Withdrawals	(10,421)	(3,381)	(3,248)
Change in market value, interest credited and other activity(1)	4,876	3,946	(2,336)
Acquisition of CIGNA's retirement business(2)	34,657	—	—
Ending total account value	\$ 66,660	\$28,658	\$22,914
Net sales (withdrawals)	\$ (1,531)	\$ 1,798	\$ 610

	Year ended December 31,		
	2004	2003	2002
	(in millions)		
Guaranteed Products(3):			
Beginning total account value	\$41,955	\$39,058	\$39,825
Sales	6,114	3,256	1,467
Withdrawals and benefits	(7,221)	(4,013)	(3,590)
Change in market value and interest income	3,694	3,281	2,166
Other(4)	(539)	373	(810)
Acquisition of CIGNA's retirement business(2)	19,143	—	—
Ending total account value	<u>\$63,146</u>	<u>\$41,955</u>	<u>\$39,058</u>
Net withdrawals	\$ (1,107)	\$ (757)	\$ (2,123)

- (1) The year ended December 31, 2002 includes increases to account values of \$360 million added to customer accounts due to Common Stock received as demutualization consideration and increases to account values of \$448 million added to customer accounts from inclusion of amounts not previously reflected in this segment.
- (2) Account values and activity related to the CIGNA retirement business include amounts acquired under reinsurance agreements.
- (3) Prudential's retirement plan accounted for 8%, 15% and 32% of sales for the years ended December 31, 2004, 2003 and 2002, respectively. This sales activity predominantly represents repricing of scheduled maturities. These scheduled maturities are also reflected in withdrawals and therefore have no impact on net sales. Ending total account value includes assets of Prudential's retirement plan of \$9.8 billion, \$9.7 billion and \$8.5 billion as of December 31, 2004, 2003 and 2002, respectively.
- (4) Represents changes in asset balances for externally managed accounts. Includes a \$152 million reduction in account value as of January 1, 2004 reflecting the adoption of SOP 03-1.

2004 to 2003 Annual Comparison. Account values in our full service defined contribution business amounted to \$66.7 billion as of December 31, 2004, an increase of \$38.0 billion from December 31, 2003, primarily reflecting \$34.7 billion of defined contribution account value acquired from CIGNA. Also contributing to this increase was a \$4.9 billion increase in the market value of mutual funds and separate accounts during 2004. These increases were partially offset by net withdrawals of \$1.5 billion, which include the withdrawal of approximately \$600 million in the first quarter of 2004 relating to retirement plans of our retail securities brokerage operations as a result of the combination of these operations with Wachovia Securities. The decline in net sales from the 2003 period was primarily due to the increase in lapses related to the acquisition of the CIGNA retirement business, as expected, and a single large case sale in the third quarter of 2003.

Account values for guaranteed products amounted to \$63.1 billion as of December 31, 2004, an increase of \$21.2 billion from December 31, 2003, primarily reflecting \$19.1 billion of defined benefit account value acquired from CIGNA. Also contributing to this increase was \$3.7 billion of market value increases and client reinvestment of interest income and dividends, which were partially offset by net withdrawals of \$1.1 billion. The increase in net withdrawals from 2003 reflects transfers in 2004 from the guaranteed products business to our Asset Management segment and a single sale in the third quarter of 2003 related to the single large defined contribution case sale discussed above.

2003 to 2002 Annual Comparison. Account values in our full service defined contribution business amounted to \$28.7 billion as of December 31, 2003, an increase of \$5.7 billion from \$22.9 billion as of December 31, 2002. The increase came primarily from increases in the market value of mutual funds and separate accounts as well as net sales of \$1.8 billion, primarily as the result of a single large case sale in the third quarter of 2003.

Account values for our guaranteed products business amounted to \$42.0 billion as of December 31, 2003, an increase of \$2.9 billion from December 31, 2002, reflecting an increase in market value and interest income partially offset by net withdrawals of \$757 million. Included in net withdrawals are sales of \$1.1 billion from the sale of funding agreements issued through our Funding Agreement Notes Issuance Program that was launched in 2003, as well a large sale in the third quarter of 2003 related to the large defined contribution case sale discussed above.

International Insurance and Investments Division

International Insurance

Our international insurance operations are subject to currency fluctuations that can materially affect their U.S. dollar results from period to period even if results on a local currency basis are relatively constant. Exchange rates fluctuated significantly for the years ended December 31, 2004, 2003 and 2002. The financial results of our International Insurance segment reflect the impact of a currency hedging program designed to mitigate the risk that unfavorable exchange rate

changes will reduce the segment's U.S. dollar equivalent earnings. This program is primarily associated with our Japanese and Korean insurance businesses. Under the program, local earnings are translated into U.S. dollar equivalent earnings at fixed rates based upon forward currency contracts executed with third parties reflected in Corporate and Other operations. Results of Corporate and Other operations include any differences between gains or losses from the contracts with third parties and the translation adjustments recorded by the International Insurance segment. These hedging transactions decreased revenues and adjusted operating income of the International Insurance segment by \$75 million and \$46 million in 2004 and 2003, respectively, and increased adjusted operating income by \$32 million in 2002. Unless otherwise stated, we have translated all information in this section, including the impact of the currency hedging program, on the basis of actual exchange rates for the periods indicated. To provide a better understanding of local operating performance, where indicated below, we have analyzed local results both on the basis of actual exchange rates and on the basis of constant exchange rates. When we discuss constant exchange rate information below, it is on the basis of the average exchange rates for the year ended December 31, 2004.

Operating Results

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

	Year ended December 31,		
	2004	2003	2002
	(in millions)		
Operating Results:			
Revenues:			
International Insurance, excluding Gibraltar Life	\$3,453	\$2,935	\$2,379
Gibraltar Life	2,982	2,720	2,694
	<u>6,435</u>	<u>5,655</u>	<u>5,073</u>
Benefits and expenses:			
International Insurance, excluding Gibraltar Life	2,938	2,486	2,000
Gibraltar Life	2,580	2,350	2,316
	<u>5,518</u>	<u>4,836</u>	<u>4,316</u>
Adjusted operating income:			
International Insurance, excluding Gibraltar Life	515	449	379
Gibraltar Life	402	370	378
	<u>917</u>	<u>819</u>	<u>757</u>
Realized investment gains (losses), net(1)	16	21	(172)
Related charges(2)	(13)	(35)	(16)
Investment gains on trading account assets supporting insurance liabilities, net(3)	68	—	—
Change in experience-rated contractholder liabilities due to asset value changes(4)	(68)	—	—
	<u>920</u>	<u>805</u>	<u>569</u>
Income from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change	\$ 920	\$ 805	\$ 569

- (1) Revenues exclude realized investment gains (losses), net. For a discussion of these items 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. For a discussion of these items see "—Realized Investment Gains and General Account Investments—Realized Investment Gains."
- (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

2004 to 2003 Annual Comparison. Gibraltar Life's adjusted operating income increased \$32 million, from \$370 million in 2003 to \$402 million in 2004, including a \$18 million favorable impact of currency fluctuations. Excluding the impact of currency fluctuations, adjusted operating income of Gibraltar Life increased \$14 million, including a \$9 million benefit in the prior year resulting from a decrease in our estimated liability for guaranty fund assessments for which the current year includes only a minimal benefit. The increase from the prior year came primarily from a more favorable level of policyholders' benefits and expenses, including the extinguishment, during 2004, of a liability established in connection with

Gibraltar Life's reorganization, partially offset by the effect of a lower than anticipated level of surrenders in the current year, requiring increases in reserves to reflect the continuation of business in force that we had expected to terminate.

Adjusted operating income from our international insurance operations, other than Gibraltar Life, increased \$66 million, from \$449 million in 2003 to \$515 million in 2004, including a \$15 million favorable impact of currency fluctuations. Excluding the impact of currency fluctuations, adjusted operating income of our international insurance operations, other than Gibraltar Life, increased \$51 million, as the impact of continued growth of our Japanese insurance operation other than Gibraltar Life and costs in 2003 of relocating to a new home office building in Tokyo were partially offset by a less favorable level of policy benefits and expenses in 2004.

The segment's increase in adjusted operating income includes the effect of year over year fluctuations in currency exchange rates as well as the impact of our hedging at expected exchange rates. On a constant exchange rate basis, excluding the impact of currency hedging, adjusted operating income, including results of Gibraltar Life, increased 7%.

2003 to 2002 Annual Comparison. Gibraltar Life's adjusted operating income decreased \$8 million, from \$378 million in 2002 to \$370 million in 2003, including a \$22 million negative impact of currency fluctuations. Excluding the impact of currency fluctuations, adjusted operating income of Gibraltar Life increased \$14 million in 2003 from 2002. This increase reflected improved investment results in 2003 and the negative impact in 2002 of refinements in estimates, primarily related to amounts due to policyholders. This increase was partially offset by a reduction in the amount of Gibraltar Life's business in force as expected during the period following its restructuring and a less favorable level of policy benefits and expenses in 2003 than the prior year.

Adjusted operating income from our international insurance operations, other than Gibraltar Life, increased \$70 million, from \$379 million in 2002 to \$449 million in 2003. Adjusted operating income of our operations in countries other than Japan increased \$56 million, from \$37 million in 2002 to \$93 million in 2003, including a \$15 million favorable impact of currency fluctuations. The \$56 million increase came primarily from our operation in Korea, reflecting strong sales and continued favorable persistency. The contribution from continued growth of our Japanese insurance operation other than Gibraltar Life and the more favorable level of policyholder benefits in 2003 was partially offset by a less favorable level of expenses which include costs of relocating to a new home office in Tokyo during the first quarter of 2003 and an \$21 million negative impact of currency fluctuations.

The segment's increase in adjusted operating income includes the effect of year over year fluctuations in currency exchange rates as well as the impact of our hedging at expected exchange rates. On a constant exchange rate basis, excluding the impact of currency hedging, adjusted operating income, including results of Gibraltar Life, increased 11%.

Revenues

2004 to 2003 Annual Comparison. Revenues, as shown in the table above under "—Operating Results," increased \$780 million, from \$5.655 billion in 2003 to \$6.435 billion in 2004, including a net favorable impact of \$370 million relating to currency fluctuations. Excluding the impact of currency fluctuations, revenues increased \$410 million, from \$6.111 billion in 2003 to \$6.521 billion in 2004. Revenues on this basis from our international insurance operations, other than Gibraltar Life, increased \$352 million. This increase in revenues came primarily from an increase in premiums and policy charges and fee income of \$284 million, from \$2.889 billion in 2003 to \$3.173 billion in 2004. Premiums and policy charges and fee income from our Japanese insurance operation other than Gibraltar Life increased \$129 million, from \$2.081 billion in 2003 to \$2.210 billion in 2004, including a \$60 million decline in premiums from single premium insurance contracts for which there was a corresponding decline in policyholders' benefits, including changes in reserves. Premiums and policy charges and fee income, excluding the premiums from single premium insurance contracts, increased \$189 million. Premiums and policy charges and fee income from our Korean operation increased \$114 million, from \$604 million in 2003 to \$718 million in 2004. The increase in premium and policy charges and fee income in both operations, excluding the effect of the single premium insurance contracts, was primarily the result of new sales and strong persistency. Premiums and policy charges and fee income in all other countries increased \$41 million from 2003 to 2004, including an increase of \$25 million from our operation in Taiwan.

Revenues for Gibraltar Life increased \$262 million, from \$2.720 billion in 2003 to \$2.982 billion in 2004, including a \$204 million favorable impact of currency fluctuations. Excluding the impact of the currency fluctuations, revenues increased \$58 million, from \$2.967 billion in 2003 to \$3.025 billion in 2004, due primarily to increased premiums from single premium life insurance contracts of \$125 million for which there was a corresponding increase in policyholders' benefits. Sales of single premium business in 2003 consisted primarily of endowment contracts, for which premiums

collected from customers are not included in reported revenues. Excluding the effect of single premium insurance contracts, revenue declined due to a reduction in the in force business.

2003 to 2002 Annual Comparison. Revenues increased \$582 million, from \$5.073 billion in 2002 to 2003, including a net favorable impact of \$272 million relating to currency fluctuations. Excluding the impact of currency fluctuations, revenues increased \$310 million, from \$5.801 billion in 2002 to \$6.111 billion in 2003. Revenues on this basis from our international insurance operations, other than Gibraltar Life, increased \$447 million. This increase in revenues came primarily from an increase in premiums and policy charges and fee income of \$400 million, from \$2.489 billion in 2002 to \$2.889 billion in 2003. Premiums and policy charges and fee income from our Japanese operation other than Gibraltar Life increased \$223 million, from \$1.858 billion in 2002 to \$2.081 billion in 2003 and premiums from our Korean operation increased \$125 million, from \$478 million in 2002 to \$603 million in 2003. The increase in premium and policy charges and fee income in both operations was primarily the result of new sales and strong persistency. Premiums in all other countries increased modestly from 2002 to 2003.

Revenues for Gibraltar Life excluding the impact of the currency fluctuations, decreased \$137 million, from \$3.104 billion in 2002 to \$2.967 billion in 2003. Gibraltar Life's decrease of \$137 million is primarily due to a \$122 million decline in premium revenue. The decline in premium revenue reflects a reduction in the in force business resulting from a higher than normal level of policy surrenders associated with the periods following Gibraltar Life's restructuring.

Benefits and Expenses

2004 to 2003 Annual Comparison. Benefits and expenses, as shown in the table above under "—Operating Results," increased \$682 million, from \$4.836 billion in 2003 to \$5.518 billion in 2004, including an unfavorable impact of \$337 million related to currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased \$345 million reflecting a \$301 million increase in our international insurance operations other than Gibraltar Life, and a \$44 million increase from Gibraltar Life. On this same basis, benefits and expenses of our Japanese insurance operation, other than Gibraltar Life, increased \$117 million from 2003 to 2004, but reflect lower policyholders' benefits, including changes in reserves, in the current period related to the single premium insurance contracts noted above. Benefits and expenses from our Korean operation increased \$134 million from \$514 million in 2003 to \$648 million in 2004. The increase in benefits and expenses in both operations, excluding the effect of the single premium insurance contracts, reflects an increase in policyholders' benefits, including changes in reserves, resulting from the aging of business in force and a greater volume of business in force, which was driven by new sales and continued strong persistency.

Gibraltar Life's benefits and expenses increased \$230 million, from \$2.350 billion in 2003 to \$2.580 billion in 2004, including an increase of \$186 million related to currency fluctuations. Excluding the impact of the currency fluctuations, benefits and expenses increased \$44 million from 2003 to 2004, reflecting an increase in policyholders' benefits, including changes in reserves associated with single premium life insurance contracts and the greater increases in policy reserves, in 2004, associated with a lower than anticipated level of surrenders. In addition, benefits and expenses for the prior period include a \$9 million benefit from decreases in our estimated liability for guaranty fund assessments for which the current year includes only a minimal benefit. These increases were partially offset by a lower level of policyholders' benefits due primarily to a reduction in the in force business and the reduction in reserves related to the extinguishment of a liability established in connection with Gibraltar Life's restructuring as well as a more favorable level of general and administrative expenses compared to the prior year.

2003 to 2002 Annual Comparison. Benefits and expenses increased \$520 million, from \$4.316 billion in 2002 to \$4.836 billion in 2003, including a negative impact of \$300 million relating currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased \$220 million reflecting a \$371 million increase in our international insurance operations, other than Gibraltar Life, partially offset by a \$151 million decrease from Gibraltar Life. The \$371 million increase in our international insurance operations, other than Gibraltar Life, reflects an increase in policyholders' benefits, including changes in reserves, and an increase in amortization of deferred policy acquisition costs resulting from the aging of business in force and a greater volume of business in force in our Japanese and Korean operations, which was driven by new sales and continued strong persistency.

Gibraltar Life's benefits and expenses increased \$34 million, from \$2.316 billion in 2002 to \$2.350 billion in 2003, including an increase of \$185 million relating to year over year fluctuations in currency exchange rates. Excluding the impact of the currency fluctuations, benefits and expenses decreased \$151 million, from \$2.694 billion in 2002 to \$2.543 billion in 2003. The \$151 million decrease is primarily due to a decrease in policyholder benefits, including changes in reserves, as a result of a continued reduction of the in force business resulting from a higher than normal level of policy surrenders associated with the periods following Gibraltar Life's restructuring.

Sales Results

In managing our international insurance business, we analyze new annualized premiums, which do not correspond to revenues under 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.

	Year ended December 31,		
	2004	2003	2002
	(in millions)		
New annualized premiums:			
On an actual exchange rate basis:			
International Insurance, excluding Gibraltar Life	\$668	\$608	\$510
Gibraltar Life	277	296	233
Total	<u>\$945</u>	<u>\$904</u>	<u>\$743</u>
On a constant exchange rate basis:			
International Insurance, excluding Gibraltar Life	\$667	\$641	\$574
Gibraltar Life	278	321	270
Total	<u>\$945</u>	<u>\$962</u>	<u>\$844</u>

2004 to 2003 Annual Comparison. On a constant exchange rate basis, new annualized premiums declined \$17 million from \$962 million in 2003 to \$945 million in 2004. On the same basis, new annualized premiums from our Japanese insurance operation other than Gibraltar Life increased \$28 million, reflecting an increase in the number of Life Planners. Sales in all other countries, also on a constant exchange rate basis, declined \$2 million, primarily reflecting a decline in sales in Korea resulting from the appointment of Life Planners to sales management positions in newly opened agencies as well as weakness in economic conditions in that country. New annualized premiums from our Gibraltar Life operation declined \$43 million, on a constant exchange rate basis, from 2003 to 2004 as sales results in the prior year benefited \$97 million from the sales of single premium insurance contracts for which the current year benefited \$41 million. Sales of our single premium insurance contracts declined due to a reduction in guaranteed rates in the latter half of 2003. Sales other than single premium insurance contracts increased 6%.

2003 to 2002 Annual Comparison. On a constant exchange rate basis, new annualized premiums increased \$118 million, from \$844 million in 2002 to \$962 million in 2003, reflecting a \$51 million increase from Gibraltar Life. On the same basis, new annualized premiums from our Japanese insurance operation other than Gibraltar Life increased \$67 million, to \$422 million in 2003, which benefited from the conclusion of an agent conference qualification period. There was no similar benefit to 2002. An increase in the Life Planner count also contributed to the growth in sales. Sales in all other countries, also on a constant exchange rate basis, were unchanged, primarily as a result of the benefit to sales in 2002 in our operation in Korea, from sales activity in anticipation of a premium rate increase in April 2002.

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 at Gibraltar, 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 2004, 2003, and 2002 was well within our pricing assumptions and below the guaranteed levels reflected in the premiums we charge.

International Investments

Operating Results

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

	Year ended December 31,		
	2004	2003	2002
	(in millions)		
Operating results:			
Revenues	\$447	\$240	\$245
Expenses	361	250	245
Adjusted operating income	86	(10)	—
Realized investment gains (losses), net(1)	(48)	(52)	—
Income (loss) from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change	\$ 38	\$ (62)	\$ —

(1) Revenues exclude realized investment gains (losses), net. For a discussion of these items see “—Realized Investment Gains and General Account Investments—Realized Investment Gains.”

Adjusted Operating Income

2004 to 2003 Annual Comparison. Adjusted operating income increased \$96 million, from a loss of \$10 million in 2003 to income of \$86 million in 2004, primarily reflecting earnings of \$53 million attributable to our acquisition of Hyundai in the first quarter of 2004, including \$20 million of fees due from the Korean government under the terms of the transaction. Also contributing to the increase in adjusted operating income were improved results from our global derivatives businesses, as well as the negative effect in 2003 of a \$34 million charge to write off a receivable related to an investment in Korea.

2003 to 2002 Annual Comparison. The segment reported a loss, on an adjusted operating income basis, of \$10 million in 2003 compared to a break-even result in 2002, as 2003 results included a charge of \$34 million to write off a receivable related to an investment in Korea. This charge was partially offset by the benefit from recently acquired units and higher earnings from our existing businesses.

Revenues

2004 to 2003 Annual Comparison. Revenues, as shown in the table above under “—Operating Results,” increased \$207 million, from \$240 million in 2003 to \$447 million in 2004, primarily as a result of our acquisition of Hyundai in the first quarter of 2004, including \$20 million of fees due from the Korean government under the terms of the transaction. Also contributing to the increase were higher revenues from our global derivatives businesses, as well as the negative effect in 2003 of a \$34 million charge to write off a receivable related to an investment in Korea.

2003 to 2002 Annual Comparison. Revenues decreased \$5 million, from \$245 million in 2002 to \$240 million in 2003, due to a charge of \$34 million recorded in 2003 to write off a receivable related to an investment in Korea. Partially offsetting this charge were higher revenues from our recently acquired units and our global derivatives businesses.

Expenses

2004 to 2003 Annual Comparison. Expenses, as shown in the table above under “—Operating Results,” increased \$111 million, from \$250 million in 2003 to \$361 million in 2004, primarily due to our acquisition of Hyundai in the first quarter of 2004 as discussed above.

2003 to 2002 Annual Comparison. Expenses increased \$5 million, from \$245 million in 2002 to \$250 million in 2003, primarily due to higher expenses corresponding with the higher level of revenues discussed above.

Corporate and Other Operations

Corporate and Other operations include corporate-level activities, after allocations to our business segments, real estate and relocation services, and businesses that we have placed in wind-down status but have not divested, which, collectively, we refer to as “Other Businesses.”

Corporate-level activities consist primarily of corporate-level income and expenses, after allocations to any of our business segments, income from our qualified pension plans and investment returns on capital that is not deployed in any of our segments. Corporate-level activities includes returns from investments that we do not allocate to any of our business segments, as well as the impact of transactions with other segments.

	Year ended December 31,		
	2004	2003	2002
	(in millions)		
Operating Results:			
Corporate-level activities(1)	\$ 83	\$ 37	\$117
Other businesses:			
Real Estate and Relocation Services	101	63	46
Other	(26)	(12)	(7)
Adjusted operating income	158	88	156
Realized investment gains (losses), net, and related adjustments(2)	(34)	(36)	(90)
Divested businesses(3)	(105)	(166)	(15)
Sales practices remedies and costs(4)	—	—	(20)
Income (loss) from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change	\$ 19	\$(114)	\$ 31

(1) Includes consolidating adjustments.

(2) See “—Realized Investment Gains and General Account Investments—Realized Investment Gains.” for a discussion of these items.

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

(4) See “—Sales Practices Remedies and Costs” for a discussion of our life insurance sales practices remedies and costs.

2004 to 2003 Annual Comparison. Corporate and Other operations had adjusted operating income of \$158 million in 2004 compared to \$88 million in 2003. Adjusted operating income from Corporate-level activities increased by \$46 million, from \$37 million in 2003 to \$83 million in 2004. Corporate-level activities includes income from our qualified pension plan of \$466 million in 2004, an increase of \$94 million from \$372 million in 2003, reflecting an increase in the allocation to other segments of pension service costs. The increase in allocated pension service costs in 2004 was partially offset by a reduction in the allocation to other segments of other benefit costs related to non-active employees that are now retained in Corporate-level activities. Corporate-level activities general and administrative expenses before qualified pension income were \$563 million in 2004, compared to \$556 million in 2003. In 2003, general and administrative expenses included \$37 million of costs related to a structured financing transaction we entered into prior to our demutualization. General and administrative expenses, other than this cost, increased \$44 million in comparison to 2003, reflecting the reduction in the allocation to other segments of other benefit costs related to non-active employees discussed above. Current period results reflect an initial \$39 million benefit from reduction in postretirement benefit costs relating to the Medicare Prescription Drug, Improvement and Modernization Act of 2003.

Corporate-level activities included \$68 million of costs in 2004 from retained obligations relating to policyholders with whom we had previously agreed to provide insurance for reduced or no premium in accordance with contractual settlements related to prior individual life sales practices remediation, as compared to \$23 million in 2003. The costs in 2004 include the impact of a reduction in our policy dividend scale. Our obligations under these settlements relate to both variable life and traditional dividend-paying policies that were issued before our demutualization. A reduction in the dividend scale determined by the Board of Directors of Prudential Insurance in late 2004 resulted in an increase in the obligation for net premiums on traditional dividend-paying policies to be absorbed by us under these settlements, which was recognized within 2004 Corporate and Other results.

For purposes of calculating pension income from our own qualified pension plan for the year ended December 31, 2005, we will continue to apply a discount rate of 5.75% and we will reduce the expected return on plan assets to 8.50% from 8.75% in 2004. In addition, the rate of increase in compensation levels will remain unchanged at 4.50% in 2005. We determined our expected return on plan assets based upon the arithmetic average of prospective returns, which is based upon a risk free rate as of the measurement date adjusted by a risk premium that considers historical statistics and expected investment manager performance, for equity, debt and real estate markets applied on a weighted average basis to our pension asset portfolio. Giving effect to the foregoing assumptions, we expect that on a consolidated basis income from our own qualified pension plan will continue to contribute to adjusted operating income in 2005, but at a level of about \$60 million to \$70 million below the 2004 contribution of \$361 million. In 2005, pension service costs related to active employees will continue to be allocated to our business segments. The allocated expenses to our business segments will be partially offset by a reduction in the allocation of other benefit costs related to non-active employees that will be retained in Corporate-level activities.

Adjusted operating income of our real estate and relocation services increased by \$38 million, from \$63 million in 2003 to \$101 million in 2004. The improvement is the result of higher revenues in our real estate franchise operations and higher operating income in our real estate financing business due to increased real estate transaction volumes and home prices.

2003 to 2002 Annual Comparison. Corporate and Other operations resulted in adjusted operating income of \$88 million in 2003 and \$156 million in 2002, a decline of \$68 million. Adjusted operating income from corporate-level activities decreased \$80 million, from \$117 million in 2002 to \$37 million in 2003. Corporate-level activities includes income from our qualified pension plan of \$372 million in 2003, a decline of \$130 million from \$502 million in 2002, reflecting a decline in the expected rate of return on plan assets from 9.50% to 8.75% and a reduction in the discount rate from 7.25% to 6.50%. Investment income, net of interest expense, declined by \$57 million, reflecting the funding of the acquisition of American Skandia and share repurchases. Corporate-level general and administrative expenses were \$556 million in 2003, before qualified pension income, compared to \$631 million in 2002, a decrease of \$75 million. General and administrative expenses for 2003 included \$37 million of costs related to a structured financing transaction. General and administrative expenses, other than this cost, decreased by \$112 million primarily due to reduced costs pertaining to certain company-wide initiatives, as well as our outsourcing of certain human resource support functions to a third party.

Corporate-level activities included \$23 million of costs in 2003 from retained obligations relating to policyholders with whom we had previously agreed to provide insurance for reduced or no premium in accordance with contractual settlements related to prior individual life sales practices remediation, as compared to \$96 million in 2002. The lower costs in 2003 were primarily attributable to improved equity market conditions in 2003. The costs in 2002 were partially offset by a \$26 million reduction of a liability we established in 2001 for death and other benefits due with respect to policies for which we had not received a death claim but where death had occurred, due to a change in our estimate.

Adjusted operating income of our real estate and relocation services increased by \$17 million, from \$46 million in 2002 to \$63 million in 2003, which benefited from decreased expenses in the 2003 period.

Results of Operations of Closed Block Business

We established the Closed Block Business effective at the date of demutualization. The Closed Block Business includes our in force traditional participating life insurance and annuity products and assets that are being 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 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 for 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. As required by GAAP, we developed an actuarial calculation of the timing of the maximum future earnings from the policies included in the Closed Block, and if actual cumulative earnings in any given period are greater than the cumulative earnings we expect, 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 policyholder dividend obligations that we recognize for the excess of actual cumulative earnings in any given period over the cumulative earnings we expect in addition to the actual policyholder dividends declared by the Board of Directors of Prudential Insurance. If cumulative performance is less favorable than we expected, the policyholder dividends we charge to expense within the Closed Block Business will be the actual dividends declared by the Board of Directors. Subsequent to the date of demutualization, there was no required charge to expense to recognize a policyholder dividend obligation for the excess of actual cumulative earnings in any given period over the cumulative earnings we expect. However, net unrealized investment gains that have arisen subsequent to the establishment of the Closed Block have been reflected as a policyholder dividend obligation to be paid to Closed Block policyholders, unless otherwise offset by future experience, with an offsetting amount reported in accumulated other comprehensive income. Accordingly, we have recorded a policyholder dividend obligation to Closed Block policyholders of \$3.141 billion as of December 31, 2004.

Operating Results

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

	Year ended December 31,		
	2004	2003	2002
	(in millions)		
GAAP results:			
Revenues	\$8,231	\$7,982	\$7,121
Benefits and expenses	7,316	7,612	7,878
Income (loss) from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change	<u>\$ 915</u>	<u>\$ 370</u>	<u>\$ (757)</u>

Income from Continuing Operations Before Income Taxes, Extraordinary Gain on Acquisition and Cumulative Effect of Accounting Change

2004 to 2003 Annual Comparison. Income from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change increased \$545 million, from \$370 million in 2003 to \$915 million in 2004. Net realized investment gains increased \$289 million, from \$426 million in 2003 to \$715 million in 2004. In addition, dividends to policyholders decreased \$88 million, reflecting reductions in the 2005 dividend scale, and operating expenses declined \$76 million. For a discussion of Closed Block Business realized investment gains (losses), net, see “—Realized Investment Gains and General Account Investments—Realized Investment Gains.”

2003 to 2002 Annual Comparison. Income from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change increased \$1.127 billion, from a loss of \$757 million in 2002 to income of \$370 million in 2003. Net realized investment gains (losses) increased \$1.013 billion, from net realized investment losses of \$587 million in 2002 to net realized investment gains of \$426 million in 2003. In addition, dividends to policyholders decreased \$54 million, reflecting reductions in the dividend scale for 2003, and operating expenses declined \$49 million. For a discussion of Closed Block Business realized investment gains (losses), net, see “—Realized Investment Gains and General Account Investments—Realized Investment Gains.”

Revenues

2004 to 2003 Annual Comparison. Revenues, as shown in the table above under “—Operating Results,” increased \$249 million, from \$7.982 billion in 2003 to \$8.231 billion in 2004. Net realized investment gains increased \$289 million, from \$426 million in 2003 to \$715 million in 2004. Premiums decreased \$84 million, from \$3.860 billion in 2003 to \$3.776 billion in 2004. We expect the decline in premiums for this business to continue as the policies in force mature or terminate in the Closed Block.

2003 to 2002 Annual Comparison. Revenues increased \$861 million, from \$7.121 billion in 2002 to \$7.982 billion in 2003. Net realized investment gains (losses) increased \$1.013 billion, from net realized investment losses of \$587 million in 2002 to net realized investment gains of \$426 million in 2003. Premiums decreased \$162 million, from \$4.022 billion in 2002 to \$3.860 billion in 2003.

Benefits and Expenses

2004 to 2003 Annual Comparison. Benefits and expenses, as shown in the table above under “—Operating Results,” decreased \$296 million, from \$7.612 billion in 2003 to \$7.316 billion in 2004. Policyholder benefits and related changes in reserves, including interest credited to policyholders’ accounts, decreased \$120 million, from \$4.313 billion in 2003 to \$4.193 billion in 2004, consistent with the decline in policies in force, as discussed above, as well as reserve adjustments recorded in 2004. Dividends to policyholders decreased \$88 million, from \$2.452 billion in 2003 to \$2.364 billion in 2004, reflecting reductions in the 2005 dividend scale based on evaluations of the experience underlying the dividend scale. Operating expenses, including distribution costs that we charge to expense, decreased \$76 million, from \$561 million in 2003 to \$485 million in 2004, reflecting lower distribution costs as we have discontinued sales of traditional products as well as our continued efforts to reduce operating cost levels.

2003 to 2002 Annual Comparison. Benefits and expenses decreased \$266 million, from \$7.878 billion in 2002 to \$7.612 billion in 2003. Policyholder benefits and related changes in reserves, including interest credited to policyholders’ accounts, decreased \$131 million, from \$4.444 billion in 2002 to \$4.313 billion in 2003, consistent with the discontinuation of sales of traditional products, as discussed above. Dividends to policyholders decreased \$54 million, from \$2.506 billion in 2002 to \$2.452 billion in 2003, reflecting reductions in the dividend scale for 2003 based on evaluations of the experience underlying the dividend scale. Operating expenses, including distribution costs that we charge to expense, decreased \$49 million, from \$610 million in 2002 to \$561 million in 2003, reflecting reduced operating cost levels.

Policy Surrender Experience

The following table sets forth policy surrender experience for the Closed Block Business, measured by cash value of surrenders, for the periods indicated. 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.

	Year ended December 31,		
	2004	2003	2002
	(in millions)		
Cash value of surrenders	\$1,435	\$1,364	\$1,234
Cash value of surrenders as a percentage of mean future policy benefit reserves	3.0%	2.9%	2.6%

2004 to 2003 Annual Comparison. The total cash value of surrenders increased \$71 million, from \$1.364 billion in 2003 to \$1.435 billion in 2004. The level of surrenders as a percentage of mean future policy benefit reserves increased from 2.9% in 2003 to 3.0% in 2004.

2003 to 2002 Annual Comparison. The total cash value of surrenders increased \$130 million, from \$1.234 billion in 2002 to \$1.364 billion in 2003. The level of surrenders as a percentage of mean future policy benefit reserves increased from 2.6% in 2002 to 2.9% in 2003.

Income Taxes

Shown below is our income tax provision (benefit) for the years ended December 31, 2004, 2003 and 2002, separately reflecting the impact of certain significant items. Also presented below is the income tax provision (benefit) that would have resulted from application of the statutory 35% federal income tax rate in each of these periods.

	Year Ended December 31,		
	2004	2003	2002
	(in millions)		
Tax provision (benefit)	\$ 955	\$ 657	\$(188)
Impact of:			
Effect of change in repatriation assumption for certain international operations	—	(120)	—
Disposition of subsidiaries	—	78	183
Non-taxable investment income	149	72	116
Tax provision (benefit) excluding these items	\$1,104	\$ 687	\$ 111
Tax provision (benefit) at statutory rate	\$1,151	\$ 693	\$ 30

For the year ended December 31, 2004, the difference between taxes excluding the items shown above and taxes that would have resulted from the application of the statutory rate is attributable, in part, to a non-taxable government subsidy for prescription drug benefits provided to retirees and foreign and domestic tax credits, partially offset by state income taxes.

For the year ended December 31, 2003, the difference between taxes excluding the items shown above and taxes that would have resulted from the application of the statutory rate is attributable, in part, to reductions in foreign tax rates and an increase in tax credits, partially offset by an increase in state income taxes.

For the year ended December 31, 2002, the difference between taxes excluding the items shown above and taxes that would have resulted from the application of the statutory rate is attributable, in part to an increase in the valuation allowance attributable to our foreign net operating losses and state net operating losses.

Discontinued Operations

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

	Year ended December 31,		
	2004	2003	2002
	(in millions)		
International securities operations	\$ (42)	\$ (97)	\$(71)
Web-based workplace distribution of voluntary benefits	—	—	(58)
Healthcare operations	6	11	71
Property and casualty operations	(2)	(28)	(32)
Other	(7)	(13)	3
Loss from discontinued operations before income taxes	(45)	(127)	(87)
Income tax benefit	(27)	(69)	(11)
Loss from discontinued operations, net of taxes	\$(18)	\$(58)	\$(76)

Realized Investment Gains and General Account Investments

Realized Investment Gains

Realized investment gains, net of losses, primarily include gains and losses resulting from sales and impairments of fixed maturity and equity investments, prepayment premiums we receive on private bond issues, and gains and losses in connection with derivative contracts that do not qualify for hedge accounting treatment.

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 six months) of the decline in value; the reasons for the decline (credit event 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. Additionally, see “—Accounting Policies & Pronouncements—Application of Critical Accounting Estimates—Valuation of Investments” above for a discussion on investment valuations.

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-related losses through sales of investments pursuant to our credit risk and portfolio management objectives. 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 derivative contracts to hedge the risk that changes in interest rates or foreign currency exchange rates will affect the market value of certain investments. We also use derivative contracts to mitigate the risk that unfavorable changes in currency exchange rates will reduce U.S. dollar equivalent earnings generated by certain of our non-U.S. businesses. 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 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 hedged assets or liabilities the same way. Accordingly, realized investment gains and losses from our hedging activities can contribute significantly to fluctuations in net income.

The comparisons below describe realized investment gains, net of losses and related charges and adjustments. Related charges, which are not applicable to the Closed Block Business, pertain to policyholder dividends, deferred policy acquisition costs, reserves for future policy benefits, and payments associated with the market value adjustment features related to certain of the annuity products we sell. A percentage of net realized investment gains on specified Gibraltar Life assets is required to be paid as dividends to Gibraltar Life policyholders. We amortize deferred policy acquisition costs for interest sensitive products based on estimated gross profits, which include net realized investment gains on the underlying invested assets. The related charge for deferred policy acquisition costs represents the amortization related to net realized investment gains. We adjust the reserves for some of our policies when cash flows related to these policies are affected by net realized investment gains, 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 offset the 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. The changes in these related charges from one period to another may be disproportionate to the changes in realized investment gains, net of losses, because the indicated adjustments relate to realized investment gains evaluated over several periods.

A portion of realized gains, pertaining to certain derivative results, is included in adjusted operating income. Pursuant to a currency hedging program, we execute forward sale contracts in the hedged currencies in exchange for U.S. dollars at a specified exchange rate. The maturities of these contracts correspond with future periods in which non-U.S. earnings are expected to be generated. These contracts do not qualify for hedge accounting under GAAP. All resulting profits or losses from such contracts, including mark-to-market adjustments of open 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 is included in adjusted operating income. In addition, we utilize 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 swap 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.

As part of the acquisition of CIGNA’s retirement business, we entered into reinsurance agreements with CIGNA, including a modified-coinsurance-with-assumption arrangement that applies to the defined-benefit guaranteed-cost contracts acquired. The net results of these contracts are recorded in “Commissions and other income,” as a result of the reinsurance arrangement, and such net results include realized investment gains and losses. Adjustments to “Realized investment gains (losses), net” include the adjustment necessary to exclude these realized investment gains and losses from adjusted operating income.

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 years ended December 31, 2004, 2003 and 2002, respectively. For a discussion of our general account investment portfolio and related results, including overall income yield and investment income, as well our policies regarding other than temporary declines in investment value and the related methodology for recording impairment charges, see “—General Account Investments” below.

	Year ended December 31,		
	2004	2003	2002
Realized investment gains (losses), net:			
Financial Services Businesses	\$ 11	\$(156)	\$ (778)
Closed Block Business	715	426	(587)
Consolidated realized investment gains (losses), net	<u>\$ 726</u>	<u>\$ 270</u>	<u>\$(1,365)</u>
Financial Services Businesses:			
Realized investment gains (losses), net			
Fixed maturity investments	\$ 114	\$ (93)	\$ (508)
Equity securities	113	23	(149)
Derivative instruments	(309)	(231)	(226)
Other	93	145	105
Total	<u>11</u>	<u>(156)</u>	<u>(778)</u>
Related adjustments	71	—	(94)
Realized investment gains (losses), net, and related adjustments	<u>\$ 82</u>	<u>\$(156)</u>	<u>\$ (872)</u>
Related charges	<u>\$ (58)</u>	<u>\$ (43)</u>	<u>\$ 6</u>
Closed Block Business:			
Realized investment gains (losses), net			
Fixed maturity investments	\$ 304	\$ 331	\$ (212)
Equity securities	317	(33)	(186)
Derivative instruments	45	64	(174)
Other	49	64	(15)
Total	<u>\$ 715</u>	<u>\$ 426</u>	<u>\$ (587)</u>

2004 to 2003 Annual Comparison

Financial Services Businesses

The Financial Services Businesses’ net realized investment gains in 2004 were \$11 million, compared to net realized investment losses of \$156 million in 2003. Realized gains in 2004 included fixed maturity impairments of \$122 million and credit-related losses of \$7 million, compared with impairments of \$266 million and credit-related losses of \$22 million in 2003. The impact of the fixed maturity impairments, which are further discussed below, and credit-related losses were more

than offset in 2004 and partly offset in 2003 by realized gains on fixed maturity sales and, to a lesser extent, private bond prepayment premiums. Realized net gains on equity securities were \$113 million in 2004, primarily due to sales in our Gibraltar Life operations and in our domestic private equity portfolio. Realized net gains on equity securities in 2003 were \$23 million, primarily reflecting impairments of \$101 million as discussed below. Realized gains in 2004 include net derivative losses of \$309 million, compared to net derivative losses of \$231 million in 2003. The losses in 2004 were primarily the result of negative mark-to-market adjustments of \$160 million on currency forward contracts used to hedge the future income of non-U.S. businesses, driven by the weakening of the U.S. dollar. Derivatives losses in 2004 also include losses of \$75 million on hedges of investments in foreign businesses and losses of \$50 million on hedges of foreign denominated investments, both driven by the weakening of the U.S. dollar, as well as losses of \$34 on treasury futures contracts used to manage the duration of the Company's fixed maturity investment portfolio. Derivative losses in 2003 were primarily the result of losses of \$161 million on foreign currency forward contracts used to hedge the future income of non-U.S. businesses, driven by the weakening of the U.S. dollar. Realized investment gains in 2004 also included a gain of \$47 million related to the sale of a real estate investment, compared to 2003 which included gains of \$47 million related to the sale of real estate investments and \$55 million related to the sale of other long-term investments.

During 2004, we recorded total other than temporary impairments of \$136 million attributable to the Financial Services Businesses, compared to total other than temporary impairments of \$382 million attributable to the Financial Services Businesses in 2003. The impairments in 2004 consisted of \$122 million relating to fixed maturities, \$9 million relating to equity securities and \$5 million relating to other invested assets which include real estate investments and investments in joint ventures and partnerships. The impairments in 2003 consisted of \$266 million relating to fixed maturities, \$101 million relating to equity securities and \$15 million relating to other invested assets as defined above.

The impairments recorded on fixed maturities in 2004 consisted of \$48 million on public securities and \$74 million on private securities, compared with fixed maturity impairments of \$61 million on public securities and \$205 million on private securities in 2003. Impairments on fixed maturities in 2004 were concentrated in the finance, services and manufacturing sectors, were primarily driven by downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers and included a private fixed maturity impairment relating to a Korean financial services company. Impairments on fixed maturities in 2003 were concentrated in the retail and wholesale, finance and other 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 2003 were impairments related to a Korean financial services company, a U.S. mining company and an Australian mining company.

We also recognized \$9 million of equity security impairments in 2004 compared with \$101 million of impairments in 2003. The impairments in 2003 primarily related to our Gibraltar Life operations and were the result of equity market declines over a prolonged period.

Closed Block Business

For the Closed Block Business, net realized investment gains in 2004 were \$715 million, compared to net gains of \$426 million in 2003. Realized gains in 2004 and 2003 included net realized gains on sales of fixed maturity securities and, to a lesser extent, private bond prepayment premiums. Partially offsetting these gains are fixed maturity impairments of \$61 million and credit-related losses of \$6 million and fixed maturity impairments of \$123 million and credit-related losses of \$46 million in 2004 and 2003, respectively. For further information on these impairments see the discussion below. We realized net gains on equity securities of \$317 million in 2004, net of \$9 million of impairments, compared to losses of \$33 million in 2003, including \$59 million of impairments which are discussed below. The net realized gains on equity securities in 2004 were primarily the result of sales as we shifted from a passive index to active management strategy. Net gains on derivatives were \$45 million in 2004, compared to gains of \$64 million in 2003. Derivative gains in 2004 and 2003 included \$37 million and \$45 million, respectively, of gains on treasury futures contracts used to manage the duration of the Company's fixed maturity investment portfolio. Derivative gains in 2003 also included gains of \$24 million on equity futures contracts. Realized investment gains in 2004 and 2003 also included \$37 million and \$41 million, respectively, of gains in connection with the partial divestiture of an equity investment in a real estate operating company.

During 2004, we recorded total other than temporary impairments of \$81 million attributable to the Closed Block Business, compared to total other than temporary impairments of \$198 million attributable to the Closed Block Business in 2003. The impairments in 2004 consisted of \$61 million relating to fixed maturities, \$9 million relating to equity securities and \$11 million relating to other invested assets as defined above. The impairments in 2003 consisted of \$123 million relating to fixed maturities, \$59 million relating to equity securities and \$16 million relating to other invested assets as defined above.

The impairments recorded on fixed maturities in 2004 consist of \$14 million on public securities and \$47 million on private securities, compared with fixed maturity impairments of \$39 million on public securities and \$84 million on private securities in 2003. Impairments in 2004 were concentrated in the services, manufacturing and asset-backed securities 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 2004 were impairments relating to a U.K. facilities management company and an electronic test equipment distributor. Impairments in 2003 were concentrated in the retail and wholesale, manufacturing and other 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 2003 were impairments relating to a European dairy and bakery goods producer, an Australian mining company and an aerospace parts manufacturer.

We also recognized \$9 million of equity security impairments in 2004 compared with \$59 million of impairments in 2003. The impairments in 2003 were the result of declines in the U.S. stock market over a prolonged period.

2003 to 2002 Annual Comparison

Financial Services Businesses

The Financial Services Businesses' net realized investment losses in 2003 were \$156 million compared to \$778 million in 2002. Realized losses in 2003 included fixed maturity impairments of \$266 million and credit-related losses of \$22 million compared with \$385 million and \$470 million for 2002, respectively. For further information on these impairments see the discussion below. Credit losses in 2002 were primarily related to adverse financial conditions concentrated in the services, utilities, and transportation sectors. Realized losses in 2003 and 2002 on fixed maturity securities were offset, in part, by realized gains driven largely by sales of fixed maturity securities in a declining rate environment, along with gains on private bond prepayment premiums. We realized net gains on equity securities of \$23 million in 2003 compared to net losses of \$149 million in 2002, which included impairments of \$101 million and \$164 million in 2003 and 2002, respectively, as discussed below. Impairments on equity securities in 2003 were more than offset by equity trading gains, primarily in Gibraltar Life, as it shifted its portfolio to a passive index strategy. Realized losses in 2003 include net derivative losses of \$231 million, compared to net derivative losses of \$226 million in 2002. The losses in 2003 included negative mark-to-market adjustments of \$161 million on forward currency contracts used to hedge the future income of non-U.S. businesses, driven by the weakening of the U.S. dollar. Derivative losses in 2002 were primarily the result of losses of \$152 million on treasury futures contracts used to manage the duration of the Company's fixed maturity investment portfolio, as well as losses of \$88 million on foreign currency forward contracts used to hedge the future income of non-U.S. businesses, driven by the weakening of the U.S. dollar.

During 2003, we recorded total other than temporary impairments of \$382 million attributable to the Financial Services Businesses, compared to total other than temporary impairments of \$585 million attributable to the Financial Services Businesses in 2002. The impairments in 2003 consisted of \$266 million relating to fixed maturities, \$101 million relating to equity securities and \$15 million relating to other invested assets as defined above. The impairments in 2002 consisted of \$385 million relating to fixed maturities, \$164 million relating to equity securities and \$36 million relating to other invested assets as defined above.

The impairments recorded on fixed maturities in 2003 consist of \$61 million on public securities and \$205 million on private securities, compared with fixed maturity impairments of \$220 million on public securities and \$165 million on private securities in 2002. Impairments in 2003 were concentrated in the retail and wholesale, finance and other 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 2003 were impairments relating to a Korean financial services company, a U.S. mining company and an Australian mining company. Impairments in 2002 were concentrated in the transportation, technology, services, finance and manufacturing sectors and were primarily driven by downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers. Included in fixed maturity impairments for 2002 are impairments relating to three U.S. airline carriers and various telecommunication companies.

We also recognized \$101 million of equity security impairments in 2003 compared with \$164 million of impairments in 2002. These impairments in both periods primarily related to our Gibraltar Life operations and were the result of equity market declines over a prolonged period.

Closed Block Business

For the Closed Block Business, net realized investment gains in 2003 were \$426 million compared to losses of \$587 million in 2002. Realized gains in 2003 reflected net realized gains on sales of fixed maturity securities in a declining rate

environment and private bond prepayment premiums, partially offset by fixed maturity impairments of \$123 million and credit-related losses of \$46 million. Realized losses in 2002 included \$302 million of fixed maturity impairments and \$420 million of credit-related losses, which were partially offset by realized gains on sales of fixed maturity securities in a declining rate environment and private bond prepayment gains. For further information on these impairments see the discussion below. Credit losses in 2002 were primarily related to adverse financial conditions concentrated in the services, utilities, and transportation sectors. We realized net losses on equity securities of \$33 million in 2003, including \$59 million of impairments, compared to losses of \$186 million in 2002, which included \$145 million of impairments. For further information on these impairments see the discussion below. Net gains on derivatives were \$64 million in 2003 compared to losses of \$174 million in 2002. The derivative losses in 2002 were largely attributable to losses on equity futures contracts and currency hedges of non-U.S. dollar investments. Realized investment gains in 2003 also include \$41 million of gains in connection with the partial divestiture of an equity investment in a real estate operating company.

During 2003, we recorded total other than temporary impairments of \$198 million attributable to the Closed Block Business, compared to total other than temporary impairments of \$476 million attributable to the Closed Block Business in 2002. The impairments in 2003 consisted of \$123 million relating to fixed maturities, \$59 million relating to equity securities and \$16 million relating to other invested assets as defined above. The impairments in 2002 consisted of \$302 million relating to fixed maturities, \$145 million relating to equity securities and \$29 million relating to other invested assets as defined above.

The impairments recorded on fixed maturities in 2003 consist of \$39 million on public securities and \$84 million on private securities, compared with fixed maturity impairments of \$157 million on public securities and \$145 million on private securities in 2002. Impairments in 2003 were concentrated in the retail and wholesale, manufacturing and other 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 2003 are impairments relating to a European dairy and bakery goods producer, an Australian mining company and an aerospace parts manufacturer. Impairments in 2002 were concentrated in the transportation, services, technology, and finance sectors and were primarily driven by downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers. Included in fixed maturity impairments for 2002 are impairments relating to various telecommunication companies and a sales and marketing company.

We also recognized \$59 million of equity security impairments in 2003 compared with \$145 million of impairments in 2002. These impairments in both periods were primarily the result of market declines over a prolonged period.

General Account Investments

We maintain a diversified investment portfolio in our insurance companies to support our liabilities to customers in our Financial Services Businesses and the Closed Block Business, as well as our other general liabilities. Our general account does not include: (1) assets of our securities brokerage, securities trading, and banking operations, (2) assets of our asset management operations, including assets managed for third parties, and (3) assets classified as “separate account assets” on our balance sheet.

The General Account portfolio is managed pursuant to the distinct objectives of the Financial Services Businesses and the Closed Block Business. The primary investment objectives of the Financial Services Businesses include:

- matching the liability characteristics of the major products and other obligations of the Company; and
- maximizing the portfolio book yield within risk constraints.

The primary investment objectives of the Closed Block Business include:

- providing for the reasonable dividend expectations of the participating policyholders within the Closed Block Business and the Class B shareholders; and
- maximizing total return and preserving principal, within risk constraints, while matching the liability characteristics of the major products in the Closed Block Business.

Management of Investments

We design asset mix strategies for our general account to match the characteristics of our products and other obligations and seek to closely approximate the interest rate sensitivity of the assets with the estimated interest rate sensitivity of the product liabilities. We achieve income objectives through asset/liability management and strategic and tactical asset allocations within a disciplined risk management framework. Our asset allocation also reflects our desire for broad diversification across asset classes, sectors and issuers.

The Investment Committee of our Board of Directors oversees our proprietary investments. It also reviews performance and risk positions quarterly. Our Senior Vice President, Asset Liability and Risk Management, approves the investment policy for the general account assets of our insurance subsidiaries and oversees the investment process for our general account. Under his direction, the Asset Liability and Risk Management Group works with our business units to develop investment objectives, performance factors and measures and asset allocation ranges.

The Asset Liability and Risk Management Group also works closely with each of our business units to ensure that the specific characteristics of our products are incorporated into its processes. The Asset Liability and Risk Management Group has the authority to initiate tactical shifts within exposure ranges approved annually by the Investment Committee. The Asset Management segment manages virtually all of our investments, other than those of our International Insurance segment, under the direction of the Asset Liability and Risk Management Group. Our International Insurance segment manages the majority of its investments locally.

Asset/Liability Management

The Asset Liability and Risk Management Group uses a disciplined, risk-controlled approach to asset/liability management. The methodology focuses on aligning assets to the effective sensitivity of the cash flow and return requirements of our liabilities. The Asset Liability and Risk Management Group consults with the product experts in the businesses on an ongoing basis to arrive at asset/liability matching policies and decisions. We adjust this dynamic process as products change, as we develop new products and as changes in the market environment occur.

We develop asset strategies for specific classes of product liabilities and attributed or accumulated surplus, each with distinct risk characteristics. Most of our products can be categorized into the following three classes:

- interest-crediting products for which the rates credited to customers are periodically adjusted to reflect market and competitive forces and actual investment experience, such as fixed annuities;
- participating individual and experience rated group products in which customers participate in actual investment and business results through annual dividends, interest or return of premium; and
- guaranteed products for which there are price or rate guarantees for the life of the contract, such as GICs.

We determine a target asset mix for each product class, which we reflect in our investment policies. Our asset/liability management process has permitted us to manage interest-sensitive products successfully through several market cycles.

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.

Our total general account investments were \$213.8 billion and \$174.7 billion as of December 31, 2004 and December 31, 2003, 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 \$146.8 billion and \$110.7 billion as of December 31, 2004 and December 31, 2003, respectively, while total general account investments attributable to the Closed Block Business were \$67.1 billion and \$64.0 billion as of December 31, 2004 and December 31, 2003, respectively. The following table sets forth the composition of the investments of our general account as of the dates indicated.

	December 31, 2004			
	Financial Services Businesses	Closed Block Business	Total	% of Total
	(\$ in millions)			
Fixed Maturities:				
Public, available for sale, at fair value	\$ 85,248	\$34,683	\$119,931	56.1%
Public, held to maturity, at amortized cost	2,624	—	2,624	1.2
Private, available for sale, at fair value	16,675	14,130	30,805	14.4
Private, held to maturity, at amortized cost	123	—	123	0.1
Trading account assets supporting insurance liabilities, at fair value	12,964	—	12,964	6.1
Other trading account assets, at fair value	130	—	130	0.1
Equity securities, available for sale, at fair value	1,651	2,620	4,271	2.0
Commercial loans, at book value	17,092	7,297	24,389	11.4
Policy loans, at outstanding balance	2,919	5,454	8,373	3.9
Other long-term investments(1)	3,931	1,047	4,978	2.3
Short-term investments	3,405	1,840	5,245	2.4
Total general account investments	146,762	67,071	213,833	100.0%
Invested assets of other entities and operations(2)	2,791	—	2,791	
Total investments	\$149,553	\$67,071	\$216,624	
	December 31, 2003			
	Financial Services Businesses	Closed Block Business	Total	% of Total
	(\$ in millions)			
Fixed Maturities:				
Public, available for sale, at fair value	\$ 66,430	\$29,538	\$ 95,968	54.9%
Public, held to maturity, at amortized cost	3,010	—	3,010	1.7
Private, available for sale, at fair value	17,921	15,052	32,973	18.9
Private, held to maturity, at amortized cost	58	—	58	—
Trading account assets supporting insurance liabilities, at fair value	88	—	88	0.1
Other trading account assets, at fair value	138	—	138	0.1
Equity securities, available for sale, at fair value	1,101	2,282	3,383	1.9
Commercial loans, at book value	11,774	7,006	18,780	10.7
Policy loans, at outstanding balance	2,609	5,543	8,152	4.7
Other long-term investments(1)	3,487	1,041	4,528	2.6
Short-term investments	4,052	3,581	7,633	4.4
Total general account investments	110,668	64,043	174,711	100.0%
Invested assets of other entities and operations(2)	6,330	—	6,330	
Total investments	\$116,998	\$64,043	\$181,041	

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

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

As of December 31, 2004, our general account investment portfolio attributable to the Financial Services Businesses consisted primarily of \$104.7 billion of fixed maturity securities (71% of the total portfolio as of December 31, 2004 compared to 79% as of December 31, 2003), \$13.0 billion of trading account assets supporting insurance liabilities (9% of the total portfolio as of December 31, 2004 compared to less than 1% as of December 31, 2003), \$17.1 billion of commercial loans (12% of the total portfolio as of December 31, 2004 compared to 11% as of December 31, 2003), \$1.7 billion of equity securities (1% of the total portfolio as of December 31, 2004 compared to 1% as of December 31, 2003) and \$10.2 billion of

other investments (7% of the total portfolio as of December 31, 2004 compared to 9% as of December 31, 2003). The increase in general account investments attributable to the Financial Services Businesses and resulting change in portfolio composition in 2004 was due primarily to approximately \$18 billion of investments added during 2004 as part of the acquisition of the retirement business of CIGNA Corporation. The majority of the investments added from this acquisition are reflected in “trading account assets supporting insurance liabilities” and “commercial loans.” The acquisition of Aoba Life on November 1, 2004 also added approximately \$5 billion of investments, primarily reflected in “fixed maturities, available for sale.” Upon the adoption of SOP 03-1 on January 1, 2004, \$3.3 billion in “separate account assets” were reclassified, primarily resulting in a \$2.8 billion increase in “fixed maturities, available for sale” and a \$0.6 billion increase in “trading account assets supporting insurance liabilities.”

As of December 31, 2004, our general account investment portfolio attributable to the Closed Block Business consisted primarily of \$48.8 billion of fixed maturity securities (73% of the total portfolio as of December 31, 2004 compared to 70% as of December 31, 2003), \$7.3 billion of commercial loans (11% of the total portfolio as of December 31, 2004 compared to 11% as of December 31, 2003), \$2.6 billion of equity securities (4% of the total portfolio as of December 31, 2004 compared to 3% as of December 31, 2003) and \$8.4 billion of other investments (12% of the total portfolio as of December 31, 2004 compared to 16% as of December 31, 2003). The increase in general account investments attributable to the Closed Block Business in 2004 was primarily due to portfolio growth as a result of the reinvestment of net investment income, partially offset by net operating outflows.

Investment Results

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.

Year ended December 31, 2004						
	Financial Services Businesses		Closed Block Business		Combined	
	Yield(1)	Amount	Yield(1)	Amount	Yield(1)	Amount
	(\$ in millions)					
Fixed maturities	4.60%	\$3,976	6.82%	\$2,709	5.29%	\$6,685
Equity securities	3.39	40	2.54	48	2.87	88
Commercial loans	6.27	962	7.93	545	6.77	1,507
Policy loans	4.71	125	6.36	338	5.81	463
Short-term investments and cash equivalents	1.70	106	2.96	72	1.92	178
Other investments	8.60	398	21.59	205	10.96	603
Gross investment income before investment expenses	4.87	5,607	6.96	3,917	5.54	9,524
Investment expenses	(0.17)	(266)	(0.25)	(236)	(0.20)	(502)
Investment income after investment expenses	4.70%	5,341	6.71%	3,681	5.34%	9,022
Investment results of other entities and operations(2)		57		—		57
Total investment income		\$5,398		\$3,681		\$9,079

Year ended December 31, 2003						
	Financial Services Businesses		Closed Block Business		Combined	
	Yield(1)	Amount	Yield(1)	Amount	Yield(1)	Amount
	(\$ in millions)					
Fixed maturities	4.82%	\$3,708	6.81%	\$2,703	5.50%	\$6,411
Equity securities	1.54	16	2.21	39	1.96	55
Commercial loans	7.15	803	8.39	564	7.61	1,367
Policy loans	5.36	150	6.40	347	6.04	497
Short-term investments and cash equivalents	1.84	104	2.17	78	1.94	182
Other investments	8.87	371	9.92	101	9.08	472
Gross investment income before investment expenses	5.12	5,152	6.73	3,832	5.70	8,984
Investment expenses	(0.16)	(224)	(0.24)	(200)	(0.19)	(424)
Investment income after investment expenses	4.96%	4,928	6.49%	3,632	5.51%	8,560
Investment results of other entities and operations(2)		120		—		120
Total investment income		\$5,048		\$3,632		\$8,680

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- (1) Yields are based on 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. Yields for 2003 are presented on a basis consistent with our current reporting practices.
- (2) Investment income of securities brokerage, securities trading and banking operations.

The overall income yield on our general account investments after investment expenses, excluding realized investment gains (losses), was 5.34% and 5.51% for the years ended December 31, 2004 and 2003, respectively.

The net investment income yield attributable to the Financial Services Businesses was 4.70% for the year ended December 31, 2004, compared to 4.96% for the year ended December 31, 2003. The decrease in yield between periods was primarily due to declines in fixed maturities and commercial loan yields primarily attributable to the impact of investment activities in a low interest rate environment and the inclusion of investments related to CIGNA's retirement business at yields below the average portfolio yields. The yields on the investments related to CIGNA's retirement business reflect the adjustment to fair value at the purchase date. The yield on the Financial Services Businesses' portfolios includes the income yield on the investment portfolio of our Japanese insurance operations, which was 2.08% for the year ended December 31, 2004, compared to 2.02% for the year ended December 31, 2003. The increase in yield on the Japanese insurance portfolio between periods is primarily attributable to an increase in U.S. dollar investments and more favorable foreign exchange rates.

The net investment income yield attributable to the Closed Block Business was 6.71% for the year ended December 31, 2004, compared to 6.49% for the year ended December 31, 2003. The increase in yield for the year ended December 31, 2004 is primarily due to more favorable results from limited partnerships within other investments.

Continuation of the current low interest rate environment will result in our reinvestment of maturing securities at lower rates and would reduce the yield we are able to earn on our investments, which support our obligations for certain products, including traditional whole life insurance, fixed annuities and guaranteed investment contracts. This reduction in yield would also have a corresponding impact on the "spread," which is the difference between the yield on our investments and the amounts that we are required to pay our customers related to these products, which could have a negative impact on our future profitability.

Fixed Maturity Securities

Investment Mix

Our fixed maturity securities portfolio consists of publicly traded and privately placed debt securities across an array of industry categories. Our international insurance portfolios are predominantly comprised of foreign government securities.

We manage our public portfolio to a risk profile directed by the Asset Liability and Risk Management Group and, in the case of our international insurance portfolios, to a profile that reflects local market regulations and our investment competencies in these markets. We seek to employ relative value analysis both in credit selection and in purchasing and selling securities. The total return that we earn on the portfolio will be reflected both as investment income and also as realized gains or losses on investments.

We use our private placement and asset-backed portfolios to enhance the diversification and yield of our overall fixed maturity portfolio. Within our domestic portfolios, we maintain a private fixed income portfolio that is larger than the industry average as a percentage of total fixed income holdings. Over the last several years, our investment staff has directly originated more than half of our annual private placement originations. Our origination capability offers the opportunity to lead transactions and gives us the opportunity for better terms, including covenants and call protection, and to take advantage of innovative deal structures.

Investments in fixed maturity securities attributable to the Financial Services Businesses were \$100.2 billion at amortized cost with an estimated fair value of \$104.7 billion as of December 31, 2004 versus \$83.0 billion at amortized cost with an estimated fair value of \$87.4 billion as of December 31, 2003.

Investments in fixed maturity securities attributable to the Closed Block Business were \$45.4 billion at amortized cost with an estimated fair value of \$48.8 billion as of December 31, 2004 versus \$41.3 billion at amortized cost with an estimated fair value of \$44.6 billion as of December 31, 2003.

Fixed Maturity Securities by Contractual Maturity Date

The following tables set forth the breakdown of our fixed maturity securities portfolio in total by contractual maturity as of December 31, 2004.

	December 31, 2004			
	Financial Services Businesses		Closed Block Business	
	Amortized Cost	% of Total	Amortized Cost	% of Total
	(\$ in millions)			
Maturing in 2005	\$ 6,161	6.1%	\$ 2,567	5.7%
Maturing in 2006	5,671	5.6	2,247	4.9
Maturing in 2007	5,477	5.5	1,776	3.9
Maturing in 2008	6,285	6.3	2,533	5.6
Maturing in 2009	6,657	6.6	2,555	5.6
Maturing in 2010	6,368	6.4	2,169	4.8
Maturing in 2011	7,114	7.1	2,908	6.4
Maturing in 2012	4,679	4.7	2,197	4.8
Maturing in 2013	3,881	3.9	2,483	5.5
Maturing in 2014 and beyond	47,952	47.8	23,989	52.8
Total Fixed Maturities	<u>\$100,245</u>	<u>100.0%</u>	<u>\$45,424</u>	<u>100.0%</u>

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)	December 31, 2004				December 31, 2003			
	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:								
Manufacturing	\$ 14,562	\$1,037	\$ 71	\$ 15,528	\$13,115	\$ 996	\$ 61	\$14,050
Finance	14,611	531	81	15,061	10,839	569	57	11,351
Utilities	8,062	684	14	8,732	6,467	630	28	7,069
Services	7,058	526	39	7,545	6,646	570	26	7,190
Energy	3,521	311	13	3,819	2,829	289	10	3,108
Retail and Wholesale	2,637	142	33	2,746	2,402	147	24	2,525
Transportation	2,415	171	17	2,569	1,800	166	4	1,962
Other	1,073	34	11	1,096	646	31	14	663
Total Corporate Securities	53,939	3,436	279	57,096	44,744	3,398	224	47,918
Foreign Government	25,321	882	148	26,055	23,075	892	91	23,876
Asset-Backed Securities	9,193	105	75	9,223	6,189	121	19	6,291
Mortgage Backed	8,017	133	23	8,127	4,966	94	28	5,032
U.S. Government	3,775	416	4	4,187	3,992	333	7	4,318
Total	<u>\$100,245</u>	<u>\$4,972</u>	<u>\$529</u>	<u>\$104,688</u>	<u>\$82,966</u>	<u>\$4,838</u>	<u>\$369</u>	<u>\$87,435</u>

- (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 \$39 million of gross unrealized gains and \$21 million of gross unrealized losses as of December 31, 2004, compared to \$42 million of gross unrealized gains and \$26 million of gross unrealized losses as of December 31, 2003 on securities classified as held to maturity, which are not reflected in other comprehensive income.

As a percentage of amortized cost, fixed maturity investments attributable to the Financial Services Businesses as of December 31, 2004, consist primarily of 25% foreign government sector, 15% finance sector, 15% manufacturing sector, 9% asset-backed securities sector, and 8% utilities sector, compared to 28% foreign government sector, 16% manufacturing sector, 13% finance sector, 8% services sector, and 8% utilities sector as of December 31, 2003. As of December 31, 2004, 93% 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 7% of mortgage-backed securities, and less than 1% of fixed maturities.

The gross unrealized losses related to our fixed maturity portfolio attributable to the Financial Services Businesses were \$0.5 billion as of December 31, 2004, compared to \$0.4 billion as of December 31, 2003. The gross unrealized losses as of

December 31, 2004 were concentrated primarily in the foreign government, finance, and manufacturing sectors, and gross unrealized losses as of December 31, 2003 were concentrated primarily in the foreign government, manufacturing 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)	December 31, 2004				December 31, 2003			
	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	\$ 8,853	\$ 770	\$ 14	\$ 9,609	\$ 9,412	\$ 770	\$ 33	\$10,149
Utilities	5,938	572	8	6,502	5,398	584	24	5,958
Finance	5,537	287	8	5,816	5,587	368	5	5,950
Services	4,948	482	6	5,424	5,088	554	10	5,632
Energy	2,354	276	2	2,628	2,280	267	3	2,544
Retail and Wholesale	2,029	183	3	2,209	1,990	200	1	2,189
Transportation	1,292	114	2	1,404	1,196	112	4	1,304
Other	27	5	—	32	29	5	—	34
Total Corporate Securities	30,978	2,689	43	33,624	30,980	2,860	80	33,760
U.S. Government	4,533	450	3	4,980	4,844	284	31	5,097
Asset-Backed Securities	4,675	41	3	4,713	2,842	45	8	2,879
Mortgage Backed	3,894	78	5	3,967	1,372	50	2	1,420
Foreign Government	1,344	187	2	1,529	1,255	182	3	1,434
Total	<u>\$45,424</u>	<u>\$3,445</u>	<u>\$ 56</u>	<u>\$48,813</u>	<u>\$41,293</u>	<u>\$3,421</u>	<u>\$124</u>	<u>\$44,590</u>

(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 December 31, 2004 consist primarily of 19% manufacturing sector, 13% utilities sector, 12% finance sector, 11% services sector, and 10% asset-backed securities sector, compared to 23% manufacturing sector, 14% finance sector, 13% utilities sector, 12% services sector, and 12% U.S. Government as of December 31, 2003. As of December 31, 2004, 87% of the mortgage-backed securities in the Closed Block Business were publicly traded agency pass-through securities related to residential mortgage loans. Collateralized mortgage obligations represented the remaining 13% of mortgage-backed securities, and 1% of fixed maturities.

The gross unrealized losses related to our fixed maturity portfolio attributable to the Closed Block Business were \$0.1 billion as of December 31, 2004, compared to \$0.1 billion as of December 31, 2003. The gross unrealized losses as of December 31, were concentrated primarily in the manufacturing, finance and utilities sectors, while gross unrealized losses as of December 31, 2003 were concentrated primarily in the manufacturing, U.S. Government and utilities sectors.

Fixed Maturity Securities Credit Quality

The Securities Valuation Office, or SVO, of the 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.

Non-U.S. dollar denominated investments of our Japanese insurance companies are not subject to NAIC guidelines; however, they 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 or rating equivalents based on Japanese government ratings.

The amortized cost of our public and private below investment grade fixed maturities attributable to the Financial Services Businesses totaled \$5.5 billion, or 5%, of the total fixed maturities as of December 31, 2004, compared to \$5.7 billion, or 7%, of total fixed maturities as of December 31, 2003. Below investment grade fixed maturities represented 16% of the gross unrealized losses attributable to the Financial Services Businesses as of December 31, 2004, versus 13% of gross unrealized losses as of December 31, 2003.

The amortized cost of our public and private below investment grade fixed maturities attributable to the Closed Block Business totaled \$5.2 billion, or 11%, of the total fixed maturities as of December 31, 2004, compared to \$5.9 billion, or 14%, of total fixed maturities as of December 31, 2003. Below investment grade fixed maturities represented 20% of the gross unrealized losses attributable to the Closed Block Business as of December 31, 2004, versus 40% of gross unrealized losses as of December 31, 2003.

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)		December 31, 2004				December 31, 2003			
NAIC Designation	Rating Agency Equivalent	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	\$63,883	\$2,500	\$276	\$66,107	\$50,133	\$2,247	\$210	\$52,170
2	Baa	17,642	988	123	18,507	13,767	900	91	14,576
	Subtotal Investment Grade	81,525	3,488	399	84,614	63,900	3,147	301	66,746
3	Ba	2,110	176	72	2,214	1,580	167	11	1,736
4	B	839	93	1	931	757	89	3	843
5	C and lower	85	13	2	96	67	30	2	95
6	In or near default	25	9	—	34	34	3	1	36
	Subtotal Below Investment Grade	3,059	291	75	3,275	2,438	289	17	2,710
	Total Public Fixed Maturities	\$84,584	\$3,779	\$474	\$87,889	\$66,338	\$3,436	\$318	\$69,456

- Reflects equivalent ratings for investments of the international insurance operations that are not rated by U.S. insurance regulatory authorities.
- Includes, as of December 31, 2004 and December 31, 2003, respectively, 10 securities with amortized cost of \$151 million (fair value, \$152 million) and 27 securities with amortized cost of \$149 million (fair value, \$151 million) that have been categorized based on expected NAIC designations pending receipt of SVO ratings.
- Includes \$38 million of gross unrealized gains and \$21 gross unrealized losses as of December 31, 2004, compared to \$41 million of gross unrealized gains and \$25 million of gross unrealized losses as of December 31, 2003 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)		December 31, 2004				December 31, 2003			
NAIC Designation	Rating Agency Equivalent	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	\$22,141	\$1,291	\$ 22	\$23,410	\$17,277	\$1,071	\$ 48	\$18,300
2	Baa	7,202	546	8	7,740	7,052	551	16	7,587
	Subtotal Investment Grade	29,343	1,837	30	31,150	24,329	1,622	64	25,887
3	Ba	2,102	199	4	2,297	1,954	190	2	2,142
4	B	1,021	86	1	1,106	1,283	109	5	1,387
5	C and lower	104	12	2	114	91	17	1	107
6	In or near default	11	5	—	16	12	3	—	15
	Subtotal Below Investment Grade	3,238	302	7	3,533	3,340	319	8	3,651
	Total Public Fixed Maturities	\$32,581	\$2,139	\$ 37	\$34,683	\$27,669	\$1,941	\$ 72	\$29,538

- Includes, as of December 31, 2004 and December 31, 2003, respectively, 9 securities with amortized cost of \$23 million (fair value, \$24 million) and 65 securities with amortized cost of \$204 million (fair value, \$211 million) that have been categorized based on expected NAIC designations pending receipt of SVO ratings.

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)		December 31, 2004				December 31, 2003			
NAIC Designation	Rating Agency Equivalent	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	\$ 4,587	\$ 321	\$ 19	\$ 4,889	\$ 4,647	\$ 400	\$ 7	\$ 5,040
2	Baa	8,652	687	25	9,314	8,749	749	13	9,485
	Subtotal Investment Grade	13,239	1,008	44	14,203	13,396	1,149	20	14,525
3	Ba	1,506	102	1	1,607	2,004	146	13	2,137
4	B	399	42	3	438	508	38	3	543
5	C and lower	293	32	1	324	552	62	12	602
6	In or near default	224	9	6	227	168	7	3	172
	Subtotal Below Investment Grade	2,422	185	11	2,596	3,232	253	31	3,454
	Total Private Fixed Maturities	\$15,661	\$1,193	\$55	\$16,799	\$16,628	\$1,402	\$51	\$17,979

- (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 December 31, 2004 and December 31, 2003, respectively, 196 securities with amortized cost of \$2,759 million (fair value, \$2,820 million) and 196 securities with amortized cost of \$2,803 million (fair value, \$2,876 million) that have been categorized based on expected NAIC designations pending receipt of SVO ratings.
- (3) Includes \$1 gross unrealized gains and zero gross unrealized losses as of December 31, 2004, compared to \$1 million of gross unrealized gains and \$1 million of gross unrealized losses as of December 31, 2003 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)		December 31, 2004				December 31, 2003			
NAIC Designation	Rating Agency Equivalent	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	\$ 3,059	\$ 338	\$ 4	\$ 3,393	\$ 2,862	\$ 336	\$ 2	\$ 3,196
2	Baa	7,817	813	11	8,619	8,205	950	9	9,146
	Subtotal Investment Grade	10,876	1,151	15	12,012	11,067	1,286	11	12,342
3	Ba	1,213	102	2	1,313	1,615	139	9	1,745
4	B	448	26	1	473	440	31	3	468
5	C and lower	234	18	—	252	362	20	6	376
6	In or near default	72	9	1	80	140	4	23	121
	Subtotal Below Investment Grade	1,967	155	4	2,118	2,557	194	41	2,710
	Total Private Fixed Maturities	\$12,843	\$1,306	\$ 19	\$14,130	\$13,624	\$1,480	\$52	\$15,052

- (1) Includes, as of December 31, 2004 and December 31, 2003, respectively, 150 securities with amortized cost of \$1,430 million (fair value, \$1,490 million) and 110 securities with amortized cost of \$1,157 million (fair value, \$1,188 million) that have been categorized based on expected NAIC designations pending receipt of SVO ratings.

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:

	December 31, 2004		December 31, 2003	
	Amortized Cost	Gross Unrealized Losses	Amortized Cost	Gross Unrealized Losses
(in millions)				
Less than six months	\$ 3	\$ 1	\$ 51	\$ 13
Six months or greater but less than nine months	—	—	—	—
Nine months or greater but less than twelve months	2	1	7	2
Twelve months and greater	—	—	—	—
Total	\$ 5	\$ 2	\$ 58	\$ 15

The gross unrealized losses as of December 31, 2004 were concentrated in the manufacturing and services sectors, while the gross unrealized losses as of December 31, 2003 were concentrated in the manufacturing and asset-backed securities sectors, as well as other corporate securities.

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:

	December 31, 2004		December 31, 2003	
	Amortized Cost	Gross Unrealized Losses	Amortized Cost	Gross Unrealized Losses
	(in millions)			
Less than six months	\$ 4	\$ 1	\$ 74	\$ 24
Six months or greater but less than nine months	—	—	—	—
Nine months or greater but less than twelve months	—	—	—	—
Twelve months and greater	—	—	—	—
Total	<u>\$ 4</u>	<u>\$ 1</u>	<u>\$ 74</u>	<u>\$ 24</u>

The gross unrealized losses as of December 31, 2004 were primarily concentrated in the foreign government securities sector, while the gross unrealized losses as of December 31, 2003 were concentrated in the manufacturing, utilities, and transportation sectors.

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.

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 six months) of the decline;
- the reasons for the decline in value (credit event 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. Estimated fair values for fixed maturities, other than private placement securities, are based on quoted market prices or prices obtained from independent pricing services. Estimated fair values for private placement fixed maturities are determined primarily by using a discounted cash flow model which considers the current market spreads between the U.S. Treasury yield curve and corporate bond yield curve, adjusted for type of issue, its current credit quality and its remaining average life. The estimated fair value of certain non-performing private placement fixed maturities is based on management's estimates.

Impairments of fixed maturity securities attributable to the Financial Services Businesses totaled \$122 million in 2004 and \$266 million in 2003. Impairments of fixed maturity securities attributable to the Closed Block Business totaled \$61 million in 2004 and \$123 million in 2003. 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 inure to contractholders. The investments supporting these experience-rated products are classified as trading. These trading investments are reflected on the balance sheet as "Trading account assets supporting insurance liabilities, at fair value." All investment results, which include realized and unrealized gains and losses, as well as net investment income, for these investments are reported in "Commissions and other income." Investment results on these assets will ultimately inure to contractholders. The following table sets forth the composition of our "trading account assets supporting insurance liabilities" portfolio as of the dates indicated.

	December 31, 2004		December 31, 2003	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(in millions)			
Short Term Investments	\$ 951	\$ 951	\$ —	\$ —
Fixed Maturities:				
U.S. Government	311	306	3	3
Foreign Government	387	390	37	38
Corporate Securities	8,866	8,765	17	15
Asset-Backed Securities	617	613	—	—
Mortgage Backed	1,494	1,492	—	—
Total Fixed Maturities	11,675	11,566	57	56
Equity Securities	378	447	32	32
Total trading account assets supporting insurance liabilities	<u>\$13,004</u>	<u>\$12,964</u>	<u>\$ 89</u>	<u>\$ 88</u>

As of December 31, 2004, 67% of the portfolio was comprised of publicly traded securities, versus 100% of the portfolio as of December 31, 2003. As of December 31, 2004, 98% of the fixed maturity portion of the portfolio was investment grade investments, versus 100% of the fixed maturity portion of the portfolio as of December 31, 2003. The changes in the net holding gain or loss on these securities during the years ended December 31, 2004 and 2003 were losses of \$108 million and \$1 million, respectively.

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)		December 31, 2004				December 31, 2003			
NAIC Designation	Rating Agency Equivalent	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	\$4,929	\$ 23	\$ 67	\$4,886	\$ 55	\$ —	\$ 1	\$ 54
2	Baa	2,454	9	31	2,431	2	—	—	2
	Subtotal Investment Grade	7,383	32	98	7,317	57	—	1	56
3	Ba	16	—	—	16	—	—	—	—
4	B	14	1	—	15	—	—	—	—
5	C and lower	2	—	—	2	—	—	—	—
6	In or near default	—	—	—	—	—	—	—	—
	Subtotal Below Investment Grade	32	1	—	33	—	—	—	—
Total Public Trading Account Assets									
	Supporting Insurance Liabilities	\$7,415	\$ 33	\$ 98	\$7,350	\$ 57	\$ —	\$ 1	\$ 56

(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.

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)		December 31, 2004				December 31, 2003			
NAIC Designation	Rating Agency Equivalent	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	\$1,168	\$ 3	\$ 24	\$1,147	\$ —	\$ —	\$ —	\$ —
2	Baa	2,852	20	51	2,821	—	—	—	—
	Subtotal Investment Grade	4,020	23	75	3,968	—	—	—	—
3	Ba	165	4	1	168	—	—	—	—
4	B	45	2	—	47	—	—	—	—
5	C and lower	22	1	1	22	—	—	—	—
6	In or near default	8	3	—	11	—	—	—	—
	Subtotal Below Investment Grade	240	10	2	248	—	—	—	—
Total Private Trading Account Assets									
	Supporting Insurance Liabilities	\$4,260	\$33	\$ 77	\$4,216	\$ —	\$ —	\$ —	\$ —

(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.

Commercial Loans

Investment Mix

We originate domestic commercial mortgages using dedicated investment staff and a network of independent companies through our various regional offices across the country. All loans are underwritten consistently to our standards using a proprietary quality rating system that has been developed from our experience in real estate and mortgage lending. Our loan portfolio strategy emphasizes diversification by property type and geographic location.

Consumer loans are loans extended by Gibraltar Life to individuals for financing purchases of consumer goods and services and are guaranteed by third party guarantor companies.

Ongoing surveillance of the portfolio is performed and loans are placed on watch list status based on a predefined set of criteria. We place loans on early warning status in cases where we detect that the physical condition of the property, the

financial situation of the borrower or tenant or other market factors could lead to a loss of principal or interest. We classify loans as closely monitored when there is a collateral deficiency or other credit events that will lead to a potential loss of principal or interest. Loans not in good standing are those loans where there is a high probability of loss of principal, such as when the loan is in the process of foreclosure or the borrower is in bankruptcy. In our domestic operations, our workout and special servicing professionals manage the loans on the watch list. In our international portfolios, we monitor delinquency in consumer loans on a pool basis and evaluate any servicing relationship and guarantees the same way we do for commercial loans.

As of December 31, 2004 and 2003, we held approximately 11% of our general account investments in commercial loans. This percentage is gross of a \$0.5 billion allowance for losses as of both December 31, 2004 and 2003.

Our loan portfolio strategy emphasizes diversification by property type and geographic location. The following tables set forth the breakdown of the gross carrying values of our commercial loan portfolio by geographic region and property type as of the dates indicated. The commercial loans that support experience-rated contracts of our Retirement segment are shown separately in the tables below.

	December 31, 2004				December 31, 2003			
	Financial Services Businesses		Closed Block Business		Financial Services Businesses		Closed Block Business	
	Gross Carrying Value	% of Total	Gross Carrying Value	% of Total	Gross Carrying Value	% of Total	Gross Carrying Value	% of Total
	(\$ in millions)							
Commercial loans by region:								
U.S. Regions:								
Pacific	\$ 2,981	17.0%	\$2,712	37.0%	\$ 2,694	22.1%	\$2,607	36.9%
South Atlantic	1,675	9.5	1,444	19.7	1,654	13.5	1,392	19.7
Middle Atlantic	1,631	9.3	1,285	17.5	1,780	14.6	1,161	16.4
East North Central	849	4.8	503	6.8	849	7.0	513	7.3
West South Central	593	3.4	403	5.5	558	4.6	308	4.4
Mountain	503	2.9	434	5.9	478	3.9	420	5.9
West North Central	458	2.6	247	3.4	410	3.4	254	3.6
New England	244	1.4	220	3.0	323	2.6	280	4.0
East South Central	174	1.0	90	1.2	202	1.6	124	1.8
Subtotal—U.S.	9,108	51.9	7,338	100.0	8,948	73.3	7,059	100.0
Asia	3,453	19.7	—	—	3,020	24.7	—	—
Other	242	1.4	—	—	242	2.0	—	—
Commercial loans supporting experience-rated contracts of the								
Retirement segment	4,742	27.0	—	—	—	—	—	—
Total Commercial Loans	\$17,545	100.0%	\$7,338	100.0%	\$12,210	100.0%	\$7,059	100.0%

	December 31, 2004				December 31, 2003			
	Financial Services Businesses		Closed Block Business		Financial Services Businesses		Closed Block Business	
	Gross Carrying Value	% of Total	Gross Carrying Value	% of Total	Gross Carrying Value	% of Total	Gross Carrying Value	% of Total
	(\$ in millions)							
Commercial loans by property type:								
Apartment complexes	\$ 2,651	15.1%	\$1,821	24.8%	\$ 2,909	23.8%	\$1,733	24.5%
Industrial buildings	2,241	12.8	1,867	25.4	1,805	14.8	1,574	22.3
Office buildings	2,043	11.6	1,480	20.2	1,770	14.5	1,585	22.4
Residential properties	1,307	7.4	4	—	1,360	11.1	6	0.1
Agricultural properties	1,012	5.8	769	10.5	1,010	8.3	854	12.1
Retail stores	856	4.9	797	10.9	906	7.4	833	11.9
Other	364	2.1	600	8.2	290	2.4	474	6.7
Subtotal of collateralized loans	10,474	59.7	7,338	100.0	10,050	82.3	7,059	100.0
Uncollateralized loans	2,329	13.3	—	—	2,160	17.7	—	—
Commercial loans supporting experience-rated contracts of the Retirement segment	4,742	27.0	—	—	—	—	—	—
Total Commercial Loans	\$17,545	100.0%	\$7,338	100.0%	\$12,210	100.0%	\$7,059	100.0%

Commercial Loans by Contractual Maturity Date

The following tables set forth the breakdown of our commercial loan portfolio by contractual maturity as of December 31, 2004.

	December 31, 2004			
	Financial Services Businesses		Closed Block Business	
	Gross Carrying Value	% of Total	Gross Carrying Value	% of Total
	(\$ in millions)			
Maturing in 2005	\$ 1,320	7.5%	\$ 194	2.7%
Maturing in 2006	1,065	6.1	282	3.8
Maturing in 2007	1,262	7.2	539	7.3
Maturing in 2008	1,604	9.1	528	7.2
Maturing in 2009	2,262	12.9	871	11.9
Maturing in 2010	817	4.6	699	9.5
Maturing in 2011	681	3.9	720	9.8
Maturing in 2012	466	2.7	533	7.3
Maturing in 2013	907	5.2	599	8.2
Maturing in 2014 and beyond	2,419	13.8	2,373	32.3
Subtotal	12,803	73.0	7,338	100.0
Commercial loans supporting experience-rated contracts of the Retirement segment	4,742	27.0	—	—
Total Commercial Loans	<u>\$17,545</u>	<u>100.0%</u>	<u>\$7,338</u>	<u>100.0%</u>

Commercial Loan Quality

We establish valuation allowances for loans that are determined to be non-performing as a result of our loan review process. We define a non-performing loan as a loan for which it is probable that amounts due according to the contractual terms of the loan agreement will not be collected. Valuation allowances for a non-performing loan are recorded based on the present value of expected future cash flows discounted at the loan's effective interest rate or based on the fair value of the collateral if the loan is collateral dependent. We record subsequent adjustments to our valuation allowances when appropriate.

The following tables set forth the gross carrying value for commercial loans by loan classification as of the dates indicated:

	December 31, 2004		December 31, 2003	
	Financial Services Businesses	Closed Block Business	Financial Services Businesses	Closed Block Business
	(in millions)			
Performing	\$12,340	\$7,334	\$11,709	\$7,029
Delinquent, not in foreclosure	366	1	391	1
Delinquent, in foreclosure	—	2	23	5
Restructured	97	1	87	24
Commercial loans supporting experience-rated contracts of the Retirement segment	4,742	—	—	—
Total Commercial Loans	<u>\$17,545</u>	<u>\$7,338</u>	<u>\$12,210</u>	<u>\$7,059</u>

The following table sets forth the change in valuation allowances for our commercial loan portfolio as of the dates indicated:

	December 31, 2004		December 31, 2003	
	Financial Services Businesses	Closed Block Business	Financial Services Businesses	Closed Block Business
	(in millions)		(in millions)	
Allowance, beginning of year	\$ 436	\$ 53	\$ 420	\$ 74
Release of allowance for losses	(8)	(10)	(15)	(20)
Charge-offs, net of recoveries	(2)	(2)	(6)	(1)
Change in foreign exchange	22	—	37	—
Commercial loans supporting experience-rated contracts of the Retirement segment	5	—	—	—
Allowance, end of year	<u>\$453</u>	<u>\$ 41</u>	<u>\$436</u>	<u>\$ 53</u>

Equity Securities

Investment Mix

Our equity securities consist principally of investments in common stock of publicly traded companies. The following table sets forth the composition of our equity securities portfolio attributable to the Financial Services Businesses and the associated gross unrealized gains and losses as of the dates indicated:

	December 31, 2004				December 31, 2003			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in millions)							
Public equity	\$1,448	\$186	\$29	\$1,605	\$ 984	\$ 97	\$38	\$1,043
Private equity	37	10	1	46	44	15	1	58
Total Equity	<u>\$1,485</u>	<u>\$196</u>	<u>\$30</u>	<u>\$1,651</u>	<u>\$1,028</u>	<u>\$112</u>	<u>\$39</u>	<u>\$1,101</u>

The following table sets forth the composition of our equity securities portfolio attributable to the Closed Block Business and the associated gross unrealized gains and losses as of the dates indicated:

	December 31, 2004				December 31, 2003			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in millions)							
Public equity	\$2,089	\$580	\$ 53	\$2,616	\$1,748	\$574	\$50	\$2,272
Private equity	3	1	—	4	6	4	—	10
Total Equity	<u>\$2,092</u>	<u>\$581</u>	<u>\$ 53</u>	<u>\$2,620</u>	<u>\$1,754</u>	<u>\$578</u>	<u>\$50</u>	<u>\$2,282</u>

Unrealized Losses from Equity Securities

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

	December 31, 2004		December 31, 2003	
	Cost	Gross Unrealized Losses	Cost	Gross Unrealized Losses
	(in millions)			
Less than six months	\$ 39	\$ 11	\$ 11	\$ 3
Six months or greater but less than nine months	—	—	—	—
Nine months or greater but less than twelve months	2	1	—	—
Twelve months and greater	—	—	3	1
Total	<u>\$ 41</u>	<u>\$ 12</u>	<u>\$ 14</u>	<u>\$ 4</u>

The gross unrealized losses as of December 31, 2004 were primarily concentrated in the services sector, while the gross unrealized losses as of December 31, 2003 were concentrated in the manufacturing and transportation sectors.

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

	December 31, 2004		December 31, 2003	
	Cost	Gross Unrealized Losses	Cost	Gross Unrealized Losses
	(in millions)			
Less than six months	\$ 27	\$ 6	\$ 13	\$ 4
Six months or greater but less than nine months	—	—	—	—
Nine months or greater but less than twelve months	—	—	—	—
Twelve months and greater	—	—	—	—
Total	<u>\$ 27</u>	<u>\$ 6</u>	<u>\$ 13</u>	<u>\$ 4</u>

The gross unrealized losses as of December 31, 2004 were primarily concentrated in the manufacturing sector, while the gross unrealized losses as of December 31, 2003 were concentrated in the retail and wholesale, manufacturing, and services sectors.

Impairments of Equity Securities

For those equity securities classified as available-for-sale we record unrealized gains and losses to the extent cost is different from estimated fair value. All securities with unrealized losses are subject to our review to identify other-than-temporary impairments in value. In evaluating whether a decline in value is other-than-temporary, we consider several factors including, but not limited to, the following:

- the extent (generally if greater than 20%) and the duration (generally if greater than six months) of the decline;
- the reasons for the decline in value (credit event or market fluctuation);
- our ability and intent to hold the 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. Estimated fair values for publicly traded equity securities are based on quoted market prices or prices obtained from independent pricing services. Estimated fair values for privately traded equity securities are determined using valuation and discounted cash flow models that call for a substantial level of judgment from management.

Impairments of equity securities attributable to the Financial Services Businesses totaled \$9 million in 2004 and \$101 million in 2003. Impairments of equity securities attributable to the Closed Block Business totaled \$9 million in 2004 and \$59 million in 2003. For a further discussion of impairments, see “—Realized Investment Gains” above.

Other Long-Term Investments

“Other long-term investments” are comprised as follows:

	December 31, 2004		December 31, 2003	
	Financial Services Businesses	Closed Block Business	Financial Services Businesses	Closed Block Business
	(in millions)			
Joint ventures and limited partnerships:				
Real estate related	\$ 225	\$ 284	\$ 84	\$ 284
Non real estate related	584	796	482	758
Real estate held through direct ownership	1,385	33	1,160	21
Separate accounts	1,361	—	1,273	—
Other	376	(66)	488	(22)
Total other long-term investments	<u>\$3,931</u>	<u>\$1,047</u>	<u>\$3,487</u>	<u>\$1,041</u>

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 inure to contractholders. The investments supporting these experience-rated products are classified as trading. These trading investments are reflected on the balance sheet as “Trading account assets supporting insurance liabilities, at fair value” and all investment results are reported in “Commissions and other income.” Results for 2004 include the recognition of \$43 million of investment losses on “Trading account assets supporting insurance liabilities, at fair value.” These losses primarily represent interest-rate related mark-to-market adjustments on fixed maturity securities. Consistent with our treatment of “Realized investment gains (losses), net,” these losses, which will ultimately inure to the contractholders, are excluded from adjusted operating income. In addition, results for 2004 include increases of \$11 million in contractholder liabilities due to asset value changes in the pool of investments that support these experience-rated contracts. These liability changes are reflected in “Interest credited to policyholders’ account balances” and are also excluded from adjusted operating income. As prescribed by GAAP, changes in the fair value of mortgage loans, other than when associated with impairments, are not recognized in income in the current period, while the impact of these changes in mortgage loan value are reflected as a change in the liability to contractholders in the current period. The change in the contractholder liability related to mortgage loans, a decrease of \$27 million for 2004, was excluded from adjusted operating income. There were no amounts recorded related to these items in 2003 and 2002.

Sales Practices Remedies and Costs

Our income from continuing operations before income taxes for the year ended December 31, 2002 includes a pre-tax charge of \$20 million of additional individual life sales practices costs including related administrative costs, litigation costs and settlements, which is reflected in our Corporate and Other operations.

Divested Businesses

Our income from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change includes results from several businesses that have been or will be sold or exited that do not qualify for “discontinued operations” accounting treatment under GAAP. The results of these divested businesses are reflected in our Corporate and Other operations, but excluded from adjusted operating income. A summary of the income from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change for these businesses is as follows for the periods indicated:

	Year ended December 31,		
	2004	2003	2002
Dryden Wealth Management	\$ (81)	\$ (4)	\$ (6)
Property and casualty insurance	(1)	(347)	71
Prudential Securities capital markets	(22)	287	(36)
Gibraltar Casualty	—	(81)	(79)
Other divested businesses	(1)	(18)	22
Total loss from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change	(105)	(163)	(28)
Less: Realized investment gains (losses), net	—	3	(13)
Divested business excluding realized investment gains (losses), net	<u>\$(105)</u>	<u>\$(166)</u>	<u>\$(15)</u>

Dryden Wealth Management

In December 2004, we committed to sell or exit our Dryden Wealth Management business that was previously included in our International Investments segment. Results of this business have been reclassified as a divested business for all periods presented. Dryden Wealth Management encompasses our private client wealth management business in Europe and Asia. Results for 2004 include a charge of \$53 million for impairment of goodwill associated with this business.

Property and Casualty Insurance

In the fourth quarter of 2003, we completed our previously announced agreements to sell our property and casualty insurance companies that operate nationally in 48 states outside of New Jersey, and the District of Columbia, to Liberty Mutual Group, or Liberty Mutual, as well as our New Jersey property and casualty insurance companies to Palisades Group. Results of the property and casualty insurance operations have been reclassified as a divested business for all periods presented. The loss in 2003 includes a charge of \$491 million, which primarily reflects the write-down of the assets to be sold to fair value and management’s best estimate of the cost of retained liabilities. The retained liabilities include pre-closing litigation and obligations under reinsurance contracts provided in connection with potential adverse loss development on the business sold to Liberty Mutual.

In addition, in 2003 we sold our specialty automobile insurance business and entered into an agreement to sell our workplace distribution property and casualty insurance operations, which closed in the first quarter of 2004. The results of operations for these businesses are included in “Loss from discontinued operations” for all periods presented.

Other Divested Businesses

The results for the Prudential Securities capital markets businesses in 2003 include the gain from a \$332 million settlement of an arbitration award. Partly offsetting this gain in 2003, are losses related to the residual investment portfolio of the business that continues to be liquidated. The losses in 2002 and 2001 also reflect the liquidation of the residual investment portfolio, as well as costs related to the wind-down of the business.

The results for the Gibraltar Casualty Company, a commercial property and casualty insurer that we sold in September 2000 to Everest Re Group, Ltd., reflect losses of \$81 million in 2003 and \$79 million in 2002 from a stop-loss reinsurance agreement we entered into pursuant to the sale, whereby if and when aggregate post-sale claim and claim-related payments exceed Gibraltar Casualty's reserves recorded at the time of sale, we will pay Everest for 80% of the first \$200 million of such excess. As of December 31, 2003, we were fully reserved for payments under this agreement.

Also reflected in other divested businesses are the results of the Prudential Home Mortgage business and certain international securities operations, as well as the operations of certain Japanese asset management units.

Liquidity and Capital Resources

Prudential Financial Liquidity

The principal sources of funds available to Prudential Financial, the parent holding company, to meet its obligations, including the payment of shareholder dividends, debt service, capital contributions and obligations to subsidiaries and operating expenses, are cash and short-term investments, dividends, returns of capital and interest income from its subsidiaries. These sources of funds are complemented by Prudential Financial's access to the capital markets and bank facilities. We believe that cash flows from these sources are sufficient to satisfy the current liquidity requirements of Prudential Financial, including reasonably foreseeable contingencies. As of December 31, 2004, Prudential Financial had cash and short-term investments of approximately \$476 million, a decrease of \$966 million, or 67%, from December 31, 2003. Principal sources and uses of cash and short-term investments at Prudential Financial for the year ended December 31, 2004 were as follows:

	2004 (in millions)
Sources:	
Dividends and returns of capital from subsidiaries(1)	\$ 1,244
Proceeds from the issuance of long-term debt(2)	1,494
Proceeds from the issuance of Common Stock(2)	690
Proceeds from the issuance of retail medium-term notes(3)	470
Proceeds from the issuance of short-term debt, net of repayments(2)	34
Other	229
Total sources	4,161
Uses:	
Capital contributions to subsidiaries(4)	(585)
Share repurchases	(1,493)
Demutualization consideration(5)	(326)
Loans with subsidiaries, net of maturities(2)	(1,620)
Transfer of cash and liabilities to subsidiary	(78)
Shareholder dividends	(341)
Purchase of funding agreements from Prudential Insurance(3)	(470)
Other	(214)
Total uses	(5,127)
Net decrease in cash and short-term investments	\$ (966)

(1) Includes dividends and/or returns of capital of \$403 million from Prudential Insurance, \$265 million from our international insurance and investments subsidiaries, \$210 million from our bank holding company, \$162 million from our asset management subsidiaries, \$140 million from American Skandia, and \$64 million from our other subsidiaries.

(2) For a discussion of this activity see "—Financing Activities."

(3) Proceeds from the issuance of retail medium-term notes under our retail note program are used to purchase funding agreements from Prudential Insurance. See "—Financing Activities" for a discussion of our retail note program.

(4) Includes capital contributions of \$384 million to our international insurance and investments subsidiaries, \$100 million to our securities business subsidiaries and \$101 million to our other subsidiaries.

(5) See "—Uses of Capital—Demutualization Consideration" for a discussion of this activity.

Sources of Capital

Prudential Financial is a holding company with insubstantial assets other than investments in subsidiaries. Its capitalization and use of financial leverage are consistent with its ratings targets. Its subsidiaries and businesses are also capitalized in accordance with their ratings targets. Our financial strength rating targets for our domestic life insurance companies are "AA/Aa/AA" for Standard & Poor's Rating Services, or S&P, Moody's Investors Service, Inc., or Moody's,

and Fitch Ratings Ltd., or Fitch, respectively, and “A+” for A.M. Best Company, or A.M. Best. For Prudential Financial, our long-term senior debt rating objectives are “A” for S&P, Moody’s and Fitch and “a” for A.M. Best. The primary components of capitalization for the Financial Services Businesses consist of the equity we attribute to the Financial Services Businesses (excluding unrealized gains and losses on investments) and outstanding borrowings of the Financial Services Businesses that are ascribed to “general corporate purposes” as discussed below under “—Financing Activities.” Based on these components, the capital position of the Financial Services Businesses as of December 31, 2004, was as follows:

	2004
	(in millions)
Attributed equity (excluding unrealized gains and losses on investments)	\$19,561
Debt used for general corporate purposes	3,480
Total capital	<u>\$23,041</u>

As shown in the table above, as of December 31, 2004, the Financial Services Businesses had approximately \$23 billion in capital, all of which was available to support the aggregate capital requirements of its three divisions and its Corporate and Other operations. Based on our assessments of these businesses and operations, we believe that the capital of the Financial Services Businesses exceeds the amount required to support its current business risks. We believe that this excess capital, combined with unused borrowing capacity as discussed below, exceeds \$2.5 billion. Although some of these resources are in our regulated subsidiaries, and their availability is subject to prior regulatory notice, approval or non-disapproval, we believe these resources give us substantial financial flexibility.

The Risk Based Capital, or RBC, ratio is the primary measure by which we evaluate the capital adequacy of Prudential Insurance, which encompasses businesses of both the Financial Services Businesses and the Closed Block Business. We manage Prudential Insurance’s RBC ratio to a level consistent with our ratings targets. RBC is determined by statutory formulas that consider risks related to the type and quality of the invested assets, insurance-related risks associated with Prudential Insurance’s products, interest rate risks and general business risks. The RBC ratio calculations are intended to assist insurance regulators in measuring the adequacy of Prudential Insurance’s statutory capitalization.

We are continuing the process of arranging reinsurance of the Closed Block. As of December 31, 2004, we have reinsured 70% of the Closed Block. Entering into these arrangements allows the RBC formula treatment of the Closed Block to reflect more closely its economic risk profile. The Closed Block continues to be adequately capitalized to meet its future obligations as discussed under “—Overview—Closed Block Business.”

On April 1, 2004, Prudential Insurance purchased CIGNA’s retirement business, which was subsequently renamed Prudential Retirement Insurance and Annuity Company, or PRIAC, for \$2.1 billion. Given the effects of the acquisition of PRIAC, the Prudential Insurance distribution to Prudential Holdings, LLC (see “—Uses of Capital—Restrictions on Dividends and Returns of Capital from Subsidiaries”), Closed Block reinsurance, and the results of its operations, Prudential Insurance continues to meet or exceed its RBC target level.

We also consider borrowing capacity in evaluating the capital position and financial flexibility of the Financial Services Businesses. We believe that a ratio of debt used for general corporate purposes to total capital equal to 20% or less is consistent with our ratings objectives for Prudential Financial. Our ratio as of December 31, 2004 of 15.1% implies that the Financial Services Businesses could incur up to \$1.4 billion in additional borrowing for general corporate purposes and remain consistent with our ratings objectives.

Uses of Capital

CIGNA Retirement Acquisition. As noted above, we used \$2.1 billion of capital within Prudential Insurance to fund the purchase price for the acquisition of CIGNA’s retirement business, which closed on April 1, 2004.

Share Repurchases. For the year ended December 31, 2004, the Company acquired 32.5 million shares of its Common Stock at a total cost of approximately \$1.5 billion.

On November 9, 2004, Prudential Financial’s Board of Directors authorized a new stock repurchase program under which Prudential Financial is authorized to purchase up to \$1.5 billion of its outstanding Common Stock in 2005. The timing and amount of any repurchases under the authorization will be determined by management based on market conditions and other considerations, and such repurchases may be effected in the open market or through negotiated transactions. This stock repurchase program supersedes all previous repurchase programs.

Demutualization Consideration. In the year ended December 31, 2004, Prudential Financial paid out \$326 million in demutualization consideration to eligible policyholders whom we have located since the time of demutualization and to governmental authorities in respect of other eligible policyholders we continue to be unable to locate. We remain obligated to disburse \$486 million of demutualization consideration to state agencies if we are unable to establish contact with eligible policyholders within time periods prescribed by state unclaimed property laws. These laws historically required remittance after periods ranging from three to seven years, but many states have enacted laws that reduce these holding periods to accelerate the reporting of unclaimed demutualization property. Liabilities relating to demutualization consideration payments were established at the time of demutualization in 2001.

Restrictions on Dividends and Returns of Capital from Subsidiaries

Our insurance and various other companies are subject to regulatory limitations on the payment of dividends and on other transfers of funds to affiliates. With respect to Prudential Insurance, New Jersey insurance law provides that, except in the case of extraordinary dividends or distributions, all dividends or distributions paid by Prudential Insurance may be declared or paid only from unassigned surplus, as determined pursuant to statutory accounting principles, less unrealized investment gains and revaluation of assets. As of December 31, 2004 and 2003, Prudential Insurance's unassigned surplus was \$3.327 billion and \$1.557 billion, respectively. There were applicable adjustments for unrealized investment gains of \$824 million and \$624 million as of December 31, 2004 and 2003, respectively. Prudential Insurance also must notify the New Jersey insurance regulator of its intent to pay a dividend. If the dividend, together with other dividends or distributions made within the preceding twelve months, would exceed a specified statutory limit, Prudential Insurance must also obtain a non-disapproval from the New Jersey insurance regulator. The current statutory limitation applicable to New Jersey life insurers generally is the greater of 10% of the prior calendar year's statutory surplus (\$8.4 billion as of December 31, 2004) or the prior calendar year's statutory net gain from operations excluding realized investment gains and losses (\$1.5 billion for the year ended December 31, 2004). In addition to these regulatory limitations, the terms of the IHC debt contain restrictions potentially limiting dividends by Prudential Insurance applicable to the Financial Services Businesses in the event the Closed Block Business is in financial distress and under other circumstances. In 2004, Prudential Insurance made a distribution of \$600 million to Prudential Holdings, LLC. Prudential Holdings, LLC in turn paid \$403 million of such distribution to Prudential Financial. The remainder of the distribution is held as collateral at Prudential Holdings, LLC for the benefit of the IHC debt holders.

The laws regulating dividends of the other states and foreign jurisdictions where our other insurance companies are domiciled are similar, but not identical, to New Jersey's. Pursuant to Gibraltar Life's reorganization, in addition to regulatory restrictions, there are certain restrictions on Gibraltar Life's ability to pay dividends to Prudential Financial. There are also regulatory restrictions on the payment of dividends by Prudential Life Insurance Company, Ltd. or Prudential of Japan. We anticipate that it will be several years before these restrictions will allow Gibraltar Life and Prudential of Japan to pay dividends. The ability of our asset management subsidiaries, and the majority of our other operating subsidiaries, to pay dividends is unrestricted.

Liquidity of Subsidiaries

Domestic Insurance Subsidiaries

General Liquidity

Liquidity refers to a company's ability to generate sufficient cash flows to meet the needs of its operations. We manage the liquidity of our domestic insurance operations to ensure stable, reliable and cost-effective sources of cash flows to meet all of our obligations. Liquidity is provided by a variety of sources, as described more fully below, including portfolios of liquid assets. The investment portfolios of our domestic and foreign insurance operations are integral to the overall liquidity of those operations. We segment our investment portfolios and employ an asset/liability management approach specific to the requirements of our product lines. This enhances the discipline applied in managing the liquidity, as well as the interest and credit risk profiles, of each portfolio in a manner consistent with the unique characteristics of the product liabilities. A projection process for cash flows from operations serves to ensure there is sufficient liquidity to meet projected cash outflows, including claims.

Liquidity is measured against internally developed benchmarks that take into account the characteristics of the asset portfolio. The results are affected substantially by the overall quality of our investments.

Cash Flow

The principal sources of liquidity of Prudential Insurance and our other domestic insurance subsidiaries are premiums and annuity considerations, investment and fee income and investment maturities and sales associated with our insurance, annuities and guaranteed products operations. Principal uses of liquidity relate to benefits, claims, dividends paid to policyholders, and payments to policyholders and contractholders in connection with surrenders, withdrawals and net policy loan activity. Uses of liquidity also include commissions, general and administrative expenses, purchases of investments, and payments in connection with financing activities.

We believe that cash flows from our insurance, annuity and guaranteed products operations are adequate to satisfy the liquidity requirements of these operations based on our current liability structure and considering a variety of reasonably foreseeable stress scenarios. The continued adequacy of this liquidity will depend upon factors such as future securities market conditions, changes in interest rate levels and policyholder perceptions of our financial strength, which could lead to reduced cash inflows or increased cash outflows.

The domestic insurance operations' cash flows from investment activities result from repayments of principal, proceeds from maturities and sales of invested assets and investment income, net of amounts reinvested. The primary liquidity risks with respect to these cash flows are the risk of default by debtors, our counterparties' willingness to extend repurchase and/or securities lending arrangements, and market volatility. We closely manage these risks through our credit risk management process and regular monitoring of our liquidity position.

In managing the liquidity of our domestic insurance operations, we also consider the risk of policyholder and contractholder withdrawals of funds earlier than our assumptions in selecting assets to support these contractual obligations. We use surrender charges and other contract provisions to mitigate the extent, timing and profitability impact of withdrawals of funds by customers from annuity contracts and deposit liabilities. The following table sets forth withdrawal characteristics of our general account annuity reserves and deposit liabilities (based on statutory liability values) as of the dates indicated.

	December 31, 2004		December 31, 2003	
	Amount	% of Total	Amount	% of Total
	(\$ in millions)			
Not subject to discretionary withdrawal provisions	\$22,229	36%	\$18,869	43%
Subject to discretionary withdrawal, with adjustment:				
With market value adjustment	18,445	30	5,603	12
At market value	1,146	2	919	2
At contract value, less surrender charge of 5% or more	2,683	4	2,535	6
Subtotal	44,503	72	27,926	63
Subject to discretionary withdrawal at contract value with no surrender charge or surrender charge of less than 5%	17,130	28	16,202	37
Total annuity reserves and deposit liabilities	\$61,633	100%	\$44,128	100%

Gross account withdrawals for our domestic insurance operations' products amounted to \$12.6 billion, including \$4.3 billion associated with the businesses of PRIAC, and \$7.8 billion for 2004 and 2003, respectively. These withdrawals include contractually scheduled maturities of general account guaranteed investment contracts of \$1,601 million and \$1,274 million for the years ended December 31, 2004 and 2003, respectively. Since these contractual withdrawals, as well as the level of surrenders experienced, were consistent with our assumptions in asset/liability management, the associated cash outflows did not have an adverse impact on our overall liquidity.

Individual life insurance policies are less susceptible to withdrawal than our annuity reserves and deposit liabilities because policyholders may incur surrender charges and undergo a new underwriting process in order to obtain a new insurance policy. Annuity benefits under group annuity contracts are generally not subject to early withdrawal.

Total annuity reserves and deposit liabilities as of December 31, 2004, shown in the table above, include \$15.1 billion related to the businesses of PRIAC. Approximately 86% of the reserves and deposit liabilities of PRIAC are subject to discretionary withdrawal with a market value adjustment.

Liquid Assets

Liquid assets include cash, cash-equivalents, short-term investments, fixed maturities and public equity securities. As of December 31, 2004 and December 31, 2003, our domestic insurance operations had \$132.8 billion, including \$13.8 billion

related to PRIAC, and \$108.2 billion in liquid assets, respectively. As of December 31, 2004, \$109.8 billion, or 91%, of the fixed maturity investments held in our domestic insurance company general account portfolios were rated investment grade. The remaining \$10.9 billion, or 9%, of fixed maturity investments were rated non-investment grade. We consider attributes of the various categories of liquid assets (for example, type of asset and credit quality) in calculating internal liquidity benchmark results in order to evaluate the adequacy of our domestic insurance operations' liquidity under a variety of stress scenarios. We believe that the liquidity profile of our assets is sufficient to satisfy liquidity requirements under reasonably foreseeable stress scenarios.

Given the size and liquidity profile of our investment portfolios, we believe that claim experience varying from our projections is not a significant liquidity risk. Our asset/liability management process takes into account the expected maturity of investments and expected payment of loss reserves as well as the specific nature and risk profile of the liabilities. Historically, there has been no significant variation between the expected maturities of our investments and the payment of loss reserves. For a further discussion of asset/liability management, see “—Realized Investment Gains and General Account Investments—General Account Investments—Asset/Liability Management.”

Our domestic insurance companies' liquidity is managed through access to substantial investment portfolios as well as a variety of instruments available for funding and/or managing short-term cash flow mismatches, including from time to time those arising from claim levels in excess of projections. To the extent we need to pay claims in excess of projections, we may borrow temporarily or sell investments sooner than anticipated to pay these claims, which may result in realized capital gains or losses or increased borrowing costs affecting results of operations. For a further discussion of realized gains or losses, see “—Realized Investment Gains and General Account Investments—Realized Investment Gains.” We believe that borrowing temporarily or selling investments earlier than anticipated will not have a material impact on the liquidity of our domestic insurance companies. Payment of claims and sale of investments earlier than anticipated would have an impact on the reported level of cash flow from operating and investing activities, respectively, in our financial statements.

Prudential Funding, LLC

Prudential Funding, LLC, or Prudential Funding, a wholly owned subsidiary of Prudential Insurance, continues to serve as a source of financing for Prudential Insurance and its subsidiaries, as well as for other subsidiaries of Prudential Financial. Prudential Funding operates under a support agreement with Prudential Insurance whereby Prudential Insurance has agreed to maintain Prudential Funding's positive tangible net worth at all times. Prudential Funding borrows funds primarily through the direct issuance of commercial paper. Prudential Funding's outstanding loans to other subsidiaries of Prudential Financial have declined over time as it transitions into a financing company primarily for Prudential Insurance and its remaining subsidiaries. While other subsidiaries continue to borrow from Prudential Funding, they also borrow from Prudential Financial and directly from third parties. The impact of Prudential Funding on liquidity is considered in the internal liquidity benchmarks of the domestic insurance operations.

As of December 31, 2004, Prudential Financial, Prudential Insurance and Prudential Funding had unsecured committed lines of credit totaling \$2.5 billion. Currently, Prudential Insurance and Prudential Funding have access to \$1.5 billion of these lines and there were no outstanding borrowings under these facilities as of December 31, 2004 or December 31, 2003. For a further discussion on lines of credit, see “—Financing Activity—Lines of Credit and Other Credit Facilities.”

International Insurance Subsidiaries

In our international insurance operations, liquidity is provided through ongoing operations as well as portfolios of liquid assets. In managing the liquidity and the interest and credit risk profiles of our international insurance portfolios, we employ a discipline similar to the discipline employed for domestic insurance subsidiaries. Liquidity is monitored through the use of internal liquidity benchmarks taking into account the liquidity of the asset portfolios.

Similar to our domestic operations, in managing the liquidity of these operations we consider the risk of policyholder and contractholder withdrawals of funds earlier than our assumptions in selecting assets to support these contractual obligations. As of December 31, 2004 and December 31, 2003, our international insurance subsidiaries had total general account insurance related liabilities (other than dividends payable to policyholders) of \$48.6 billion and \$38.3 billion, respectively. Of those amounts, \$29.7 billion and \$28.8 billion, respectively, are associated with Gibraltar Life, our largest international insurance subsidiary. Concurrent with our acquisition of Gibraltar Life in April 2001, substantially all of its insurance liabilities were restructured, under a reorganization, to include special surrender penalties on existing policies. These charges mitigate the extent, timing, and profitability impact of withdrawals of funds by customers and apply to \$25.8 billion and \$25.8 billion of Gibraltar Life's insurance related reserves as of December 31, 2004, and December 31, 2003,

respectively. The following table sets forth the schedule (for each fiscal year ending March 31) of special surrender charges on policies that were in force at the time of the acquisition:

<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
15%	14%	12%	10%	8%	6%	4%	2%

Policies issued by Gibraltar Life post-acquisition are not subject to the above restructured policy surrender charge schedule. Policies issued post-acquisition are subject to discretionary withdrawal at contract value, less applicable surrender charges, which are currently 5% or more.

In the years 2005 and 2009, a special dividend to certain Gibraltar Life policyholders will be payable based on 67% of net realized investment gains, if any, over the value of real estate and loans, net of transaction costs and taxes, included in the Reorganization Plan. As of December 31, 2004, a liability of \$975 million is included in "Policyholders' dividends" to cover the special dividend. The special dividend will take the form of either additional policy values or cash. We expect that the 2005 installment will be approximately \$670 million, based upon realized investment gains as of December 31, 2004, and will be mostly in the form of additional policy values. Gibraltar's investment portfolio is structured to provide adequate liquidity for the special dividend.

Prudential of Japan, with \$10.4 billion and \$7.8 billion of general account insurance related liabilities (other than dividends to policyholders) as of December 31, 2004, and December 31, 2003, respectively, is our second largest international insurance subsidiary. Prudential of Japan did not have a material amount of general account annuity reserves and deposit liabilities subject to discretionary withdrawal as of December 31, 2004 or December 31, 2003. Additionally, we believe that the individual life insurance policies sold by Prudential of Japan do not have significant withdrawal risk because policyholders may incur surrender charges and must undergo a new underwriting process in order to obtain a new insurance policy.

In November 2004, Prudential of Japan purchased Aoba Life Insurance Company, Ltd., or Aoba Life. Aoba Life is a Japanese life insurer with a run-off book of insurance contracts and is the successor entity to the former Nissan Mutual Life Insurance Company, which was restructured in June 1997. Aoba Life was merged into Prudential of Japan in February 2005. Aoba Life had \$5.9 billion of general account insurance related liabilities (other than dividends to policyholders) as of December 31, 2004. Aoba Life did not have a material amount of general account annuity reserves and deposit liabilities subject to discretionary withdrawal as of December 31, 2004. Additionally, we believe that the individual life insurance policies sold by Aoba Life do not have significant withdrawal risk because of the time elapsed since the restructuring and policyholders must undergo a new underwriting process to obtain a new insurance policy.

As of December 31, 2004 and December 31, 2003, our international insurance subsidiaries had cash and short-term investments of approximately \$3.6 billion, including \$1.0 billion from Aoba Life, and \$1.6 billion, respectively, and fixed maturity investments with fair values of \$38.0 billion, including \$3.6 billion from Aoba Life, and \$30.3 billion, respectively. We believe that ongoing operations and the liquidity profile of our international insurance assets provide sufficient liquidity in reasonably foreseeable stress scenarios.

Prudential Securities Group

Prudential Securities Group's assets totaled \$7.1 billion and \$7.5 billion as of December 31, 2004 and December 31, 2003, respectively. The businesses within Prudential Securities Group, including our investment in Wachovia Securities, continue to maintain sufficiently liquid balance sheets consisting mostly of cash and cash equivalents, segregated client assets, short-term collateralized receivables from clients and broker-dealers, and collateralized loans to clients. Distributions from our investment in Wachovia Securities to Prudential Securities Group totaled \$80.3 million and \$24.7 million for the years ended December 31, 2004 and 2003, respectively. Prudential Securities Group's total capitalization, including equity, subordinated debt and long-term debt, was \$2.0 billion and \$2.4 billion as of December 31, 2004 and December 31, 2003, respectively. As of December 31, 2004, Prudential Securities Group had remaining assets amounting to approximately \$386 million related to its former institutional fixed income activities, compared to \$700 million as of December 31, 2003.

Financing Activities

As of December 31, 2004 and December 31, 2003, total short- and long-term debt of the Company was \$11.7 billion and \$10.3 billion, respectively, including debt associated with the Financial Services Businesses and the Closed Block Business. Outstanding short- and long-term debt of Prudential Financial, the parent company, amounted to \$4.6 billion as of December 31, 2004 and \$2.6 billion as of December 31, 2003, which is included in the total consolidated outstanding short- and long-term debt of the Company.

Prudential Financial is authorized to borrow funds from various sources to meet its capital needs, as well as the capital needs of its subsidiaries. The following table sets forth the outstanding short- and long-term debt of Prudential Financial, as of the dates indicated:

	December 31, 2004	December 31, 2003
	(in millions)	
Borrowings:		
General obligation short-term debt	\$ 446	\$ 412
General obligation long-term debt:		
Senior debt	3,658	1,492
Retail medium-term notes	470	—
Debt related to Equity Security Units(1)	—	711
Total general obligations	<u>\$4,574</u>	<u>\$2,615</u>

(1) The \$711 million represents the carrying value of the debt associated with the Equity Security Units that was issued at the time of demutualization. As of December 31, 2004, the debt formerly associated with the Equity Security Units is reflected in senior debt.

Prudential Financial's short-term debt includes commercial paper borrowings of \$446 million and \$412 million as of December 31, 2004 and December 31, 2003, respectively. The weighted average interest rate on the commercial paper borrowings under this program was 1.44% and 1.21% for the years ended December 31, 2004 and December 31, 2003, respectively.

To enhance financial flexibility, Prudential Financial filed a \$5 billion shelf registration statement, effective April 25, 2003, with the Securities and Exchange Commission, which permits the issuance of public debt, equity and hybrid securities. The total principal amount of debt outstanding under this shelf program as of December 31, 2004 was \$4.2 billion.

The total principal amount of debt outstanding under Prudential Financial's domestic medium-term note and senior note programs as of December 31, 2004 and December 31, 2003 was \$3.7 billion and \$1.5 billion, respectively. The weighted average interest rates on Prudential Financial's long-term debt, including the effect of interest rate hedging activity, were 4.20% and 3.76% for the years ended December 31, 2004 and 2003, respectively.

On September 15, 2004, Prudential Financial issued \$1 billion of senior debt under the above registration statement with a stated coupon interest rate of 5.10% and maturing on September 20, 2014. The net proceeds from the sale of the notes were used for general corporate purposes, including primarily a loan to one of our domestic insurance subsidiaries. The individual life business used the majority of this financing to replace reliance on 364-day letter of credit facilities supporting reserve credits achieved through reinsurance on certain term insurance business. This transaction reduced rollover and repricing risks with respect to those letter of credit facilities.

In connection with Prudential Financial's initial public offering in December 2001, Prudential Financial and Prudential Financial Capital Trust I, or PFCTI, issued equity security units, or the units. Each unit originally consisted of (1) a contract to purchase shares or the Purchase Contracts of Prudential Financial's Common Stock in November 2004; and (2) a capital security of PFCTI.

In accordance with the terms of the units, PFCTI was dissolved on July 29, 2004, and \$690 million aggregate principal amount of 5.34% debentures of Prudential Financial, the sole assets of PFCTI, were distributed to the owners of PFCTI's capital securities in exchange for their capital securities. The Prudential Financial debentures were remarketed on behalf of the debenture holders on August 11, 2004, and the interest rate on the Prudential Financial debentures was reset as of August 16, 2004 to 4.104% per annum for a yield to maturity of 3.424%. The final maturity of the Prudential Financial debentures is November 15, 2006.

In November 2004, the Purchase Contracts associated with our equity security units were settled. In exchange for \$690 million, Prudential Financial issued 1.47 shares of Common Stock per purchase contract, or approximately 20.3 million newly issued shares.

On March 25, 2004, Prudential Financial allocated \$1.0 billion of the \$5.0 billion shelf registration for the purpose of issuing retail medium-term notes. This retail note program represents a funding source for a spread product of our Retirement segment that is economically similar to funding agreement-backed Guaranteed Investment Contracts, or GICs, issued to institutional investors, except that the notes are senior obligations of Prudential Financial and are purchased by retail investors. The total principal amount of debt outstanding under this program as of December 31, 2004 was \$470 million. The weighted average interest rate on this debt, including the effect of interest rate hedging activity, was 2.85% for the year ended 2004.

Effective June 2004, we formally allocated all of the \$1.0 billion of the unsecured committed line of credit expiring in May of 2009 to Prudential Financial. There were no outstanding borrowings under this facility as of December 31, 2004. For a discussion of our lines of credit, see “—Lines of Credit and Other Credit Facilities” below.

Current capital markets activities for the consolidated company principally consist of unsecured short-term and long-term debt borrowings issued by Prudential Funding and Prudential Financial, unsecured third party bank borrowing, and asset-based or secured forms of financing. The secured financing arrangements include transactions such as securities lending and repurchase agreements, which we generally use to finance liquid securities in our short-term spread portfolios, primarily within Prudential Insurance.

The following table sets forth total consolidated borrowings of the Company as of the dates indicated:

	December 31, 2004	December 31, 2003
	(in millions)	
Borrowings:		
General obligation short-term debt	\$ 4,043	\$ 4,738
General obligation long-term debt:		
Senior debt	5,128	2,400
Surplus notes	692	691
Debt related to Equity Security Units(1)	—	711
Total general obligation long-term debt	5,820	3,802
Total general obligations	9,863	8,540
Limited and non-recourse borrowing:		
Limited and non-recourse short-term debt	1	1
Limited and non-recourse long-term debt(2)	1,807	1,808
Total limited and non-recourse borrowing	1,808	1,809
Total borrowings(3)	11,671	10,349
Total asset-based financing	16,654	17,038
Total borrowings and asset-based financings	\$28,325	\$27,387

(1) The \$711 million represent the carrying value of the debt associated with the Equity Security Units that was issued at the time of demutualization. As of December 31, 2004, the debt formerly associated with the Equity Security Units is reflected in senior debt.

(2) As of December 31, 2004 and December 31, 2003, \$1.75 billion of limited and non-recourse debt outstanding is attributable to the Closed Block Business.

(3) Does not include \$2.8 billion and \$1.1 billion of medium-term notes of consolidated trust entities secured by funding agreements purchased with the proceeds of such notes as of December 31, 2004 and December 31, 2003, respectively. These notes are included in “Policyholders’ account balances.” For additional information see “—Funding Agreement Notes Issuance Program.”

Total general debt obligations increased by \$1.323 billion, or 15%, from December 31, 2003 to December 31, 2004, reflecting a \$2.018 billion net increase in long-term debt and a \$695 million net decrease in short-term debt. The increase in long-term debt was driven primarily by \$1.5 billion of long-term debt issuance by Prudential Financial, as well as \$470 million of retail medium-term notes issued under our retail note program by Prudential Financial. The net decrease in short-term debt was driven by the decreased aggregate needs of our businesses.

Asset-based financing decreased by approximately \$384 million, primarily due to market opportunities in our spread and hedge portfolios.

Prudential Funding’s commercial paper and master note borrowings as of December 31, 2004 and December 31, 2003, were \$2.1 billion and \$2.8 billion, respectively. In the second quarter of 2002, Prudential Financial issued a subordinated guarantee covering Prudential Funding’s domestic commercial paper program. The weighted average interest rates on the commercial paper borrowings and master notes were 1.34%, 1.13% and 1.26% for the years ended December 31, 2004, 2003 and 2002, respectively.

The total principal amount of debt outstanding under Prudential Funding’s domestic medium-term note programs as of December 31, 2004 and December 31, 2003 was \$772 million and \$1.2 billion, respectively. The weighted average interest rates on Prudential Funding’s long-term debt, including the effect of interest rate hedging activity, were 2.13%, 1.87%, and 3.21% for the years ended December 31, 2004, 2003 and 2002, respectively.

Prudential Insurance had outstanding surplus notes totaling \$692 million and \$691 million as of December 31, 2004 and December 31, 2003. These debt securities, which are included as surplus of Prudential Insurance on a statutory accounting basis, are subordinated to other Prudential Insurance borrowings and to policyholder obligations and are subject to regulatory approvals for principal and interest payments.

Our total borrowings consist of amounts used for general corporate purposes, investment related debt, securities business related debt and debt related to specified other businesses. Borrowings used for general corporate purposes include those used for cash flow timing mismatches at Prudential Financial, Prudential Financial's investments in equity and debt securities of subsidiaries and amounts utilized for regulatory capital purposes. Investment related borrowings consist of debt issued to finance specific investment assets or portfolios of investment assets, including institutional spread lending investment portfolios, real estate and real estate related investments held in consolidated joint ventures, as well as institutional and insurance company portfolio cash flow timing differences. Securities business related debt consists of debt issued to finance primarily the liquidity of our broker-dealers and our capital markets and other securities business related operations. Debt related to specified other businesses consists of borrowings associated with our discontinued consumer banking business, the individual annuity business, real estate franchises and relocation services. Borrowings under which either the holder is entitled to collect only against the assets pledged to the debt as collateral, or has only very limited rights to collect against other assets, have been classified as limited and non-recourse debt. Consolidated borrowings as of December 31, 2004 and December 31, 2003 include \$1.75 billion of limited and non-recourse debt attributable to the Closed Block Business.

The following table summarizes our borrowings, categorized by use of proceeds, as of the dates indicated:

	December 31, 2004	December 31, 2003
	(in millions)	
General obligations:		
General corporate purposes	\$ 3,480	\$ 1,966
Investment related	2,593	1,542
Securities business related	2,998	2,909
Specified other businesses	792	1,412
Equity Security Units(1)	—	711
Total general obligations	9,863	8,540
Limited and non-recourse debt	1,808	1,809
Total borrowings	\$11,671	\$10,349
Short-term debt	\$ 4,044	\$ 4,739
Long-term debt	7,627	5,610
Total borrowings	\$11,671	\$10,349
Borrowings of Financial Services Businesses	\$ 9,773	\$ 8,599
Borrowings of Closed Block Business	1,898	1,750
Total borrowings	\$11,671	\$10,349

(1) The \$711 million represent the carrying value of the debt associated with the Equity Security Units issued at the time of demutualization. As of December 31, 2004, the debt formerly associated with the Equity Security Units is reflected in "Securities business related."

Funding Agreement Notes Issuance Program

In 2003, Prudential Insurance established a Funding Agreement Notes Issuance Program pursuant to which a Delaware statutory trust issues medium-term notes (which are included in our statements of financial position in "Policyholders' account balances" and not included in the foregoing table) secured by funding agreements issued to the trust by Prudential Insurance and included in our Retirement segment. The funding agreements provide cash flow sufficient for the debt service on the medium-term notes. The medium-term notes are sold in transactions not requiring registration under the Securities Act. As of December 31, 2004 and December 31, 2003 the outstanding amount of such notes totaled approximately \$2.8 billion and \$1.1 billion, respectively, out of an aggregate authorized amount of \$6 billion. The notes have fixed or floating interest rates and original maturities ranging from two years to five years.

Notes Issued to Prudential Insurance

At the time of demutualization, Prudential Financial made a contribution to Prudential Insurance which was financed with proceeds from the purchase by Prudential Insurance of a series of notes issued by Prudential Financial with market rates of interest and maturities ranging from nineteen months to three years. In the year ended December 31, 2004, \$600 million of notes matured. As of December 31, 2004, \$150 million of the notes are outstanding; they mature in the first quarter of 2005.

Lines of Credit and Other Credit Facilities

As of December 31, 2004, Prudential Financial, Prudential Insurance and Prudential Funding had unsecured committed lines of credit totaling \$2.5 billion. Of this amount, \$1.0 billion is under a facility entered into during May 2004, which

expires in May 2009, and \$1.5 billion is under a facility that expires in October 2006. Borrowings under the outstanding facilities will mature no later than the respective expiration dates of the facilities. The facility expiring in May 2009 includes 19 financial institutions, many of which are also among the 27 financial institutions participating in the October 2006 facility. We use these facilities primarily as back-up liquidity lines for our commercial paper programs, and there were no outstanding borrowings under these facilities as of December 31, 2004 or December 31, 2003. Effective June 2004, we formally allocated the \$1.0 billion of the May 2009 facility to Prudential Financial.

Our ability to borrow under these facilities is conditioned on our continued satisfaction of customary conditions, including maintenance at all times by Prudential Insurance of total adjusted capital of at least \$5.5 billion based on statutory accounting principles prescribed under New Jersey law. Prudential Insurance's total adjusted capital as of December 31, 2004, was approximately \$11.8 billion and continues to be above the \$5.5 billion threshold. The ability of Prudential Financial to borrow under these facilities is conditioned on its maintenance of consolidated net worth of at least \$12.5 billion, based on GAAP. Prudential Financial's consolidated net worth totaled \$22.3 billion and \$21.3 billion as of December 31, 2004 and December 31, 2003, respectively. In addition, we have a credit facility expiring in December 2007 utilizing a third party-sponsored, asset-backed commercial paper conduit, under which we can borrow up to \$750 million. This facility is supported in its entirety by unsecured committed lines of credit from many of the financial institutions included in our other facilities. Our actual ability to borrow under this facility depends on market conditions, and with respect to the lines of credit, Prudential Financial is subject to the same net worth requirement as with our other facilities. We also use uncommitted lines of credit from banks and other financial institutions.

Contractual Obligations

The following table summarizes our major contractual obligations as of December 31, 2004:

	Total	Payments Due by Period			
		Less than 1 Year	1 – 3 Years	3 – 5 Years	More than 5 Years
		(in millions)			
Long-term debt(1)	\$ 7,627	\$ —	\$ 1,017	\$ 1,147	\$ 5,463
Operating leases(1)	1,047	214	356	213	264
Other long-term liabilities:					
Insurance liabilities(2)	48,966	4,551	7,161	6,186	31,068
Undistributed demutualization consideration(3)	486	314	126	46	—
Total	<u>\$58,126</u>	<u>\$5,079</u>	<u>\$8,660</u>	<u>\$7,592</u>	<u>\$36,795</u>

(1) See Footnote 21 to the Consolidated Financial Statements for additional information.

(2) Insurance liabilities, reflected in the contractual obligations table above, include products for which we are currently making periodic payments, including but not limited to, structured settlements, supplemental contracts, pension closeouts, group short- and long-term disability products and certain annuity contracts.

Insurance liabilities, reflected in the contractual obligations table above, also include products for which we are not currently making periodic payments, but for which we believe the amount and timing of future payments is essentially fixed and determinable. The contractholders generally cannot readily withdraw funds on these contracts. These amounts include, but are not limited to, structured settlements, pension closeouts, certain annuity contracts, guaranteed interest contracts and funding agreements with contractually scheduled maturities and group long-term disability products.

Liabilities for future policy benefits of approximately \$63.3 billion, policyholder account balances of approximately \$86.8 billion and unpaid claims and claim adjustment expenses of approximately \$0.3 billion as of December 31, 2004 have been excluded from the contractual obligations table. Such excluded liabilities include, but are not limited to, future policy benefits relating to life insurance products, individual disability income claim reserves that are 100% coinsured, and endowments and policyholder account balances relating to deferred/accumulation annuities and universal life products. Significant uncertainties relating to these liabilities include mortality, morbidity, expenses, persistency, investment returns, inflation and the timing of payments.

Amounts included in insurance liabilities within the contractual obligations table reflect estimated cash payments to be made to policyholders. Such cash outflows reflect adjustments for the estimated timing of mortality, retirement, and other appropriate factors, but are undiscounted with respect to interest. As a result, the sum of the cash outflows shown for all years in the table of \$49.0 billion exceeds the corresponding liability amounts of \$28.9 billion included in the consolidated financial statements as of December 31, 2004. The liability amount in the consolidated financial statements reflects the discounting for interest as well as adjustments for the timing of other factors as described above.

(3) Prudential Financial remains obligated to disburse demutualization consideration for eligible policyholders that we have been unable to locate. To the extent we continue to be unable to establish contact with these policyholders within a prescribed period of time specified by state escheat laws the funds must be remitted to governmental authorities. The amounts reflected in the table above are reflective of state escheat laws as of December 31, 2004. These liabilities are reflected within "Other liabilities" on our consolidated statements of financial position.

We enter into agreements to purchase goods and services in the normal course of business; however, these purchase obligations are not material to our consolidated results of operations or financial position as of December 31, 2004.

Off-Balance Sheet Arrangements

Guarantees

In the course of our business, we provide certain guarantees and indemnities to third parties pursuant to which we may be contingently required to make payments now or in the future.

A number of guarantees provided by us relate to real estate investments, in which the investor has borrowed funds, and we have guaranteed their obligation to their lender. In some cases, the investor is an affiliate, and in other cases the unaffiliated investor purchases the real estate investment from us. We provide these guarantees to assist the investor in obtaining financing for the transaction on more beneficial terms. Our maximum potential exposure under these guarantees was \$1.315 billion as of December 31, 2004. Any payments that may become required of us under these guarantees would either first be reduced by proceeds received by the creditor on a sale of the assets, or would provide us with rights to obtain the assets. These guarantees expire at various times over the next 10 years. As of December 31, 2004, no amounts were accrued as a result of our assessment that it is unlikely payments will be required.

Certain contracts underwritten by the Retirement segment's guaranteed products business include guarantees related to financial assets owned by the guaranteed party. These contracts are accounted for as derivatives, at fair value, in accordance with SFAS No. 133. As of December 31, 2004, such contracts in force carried a total guaranteed value of \$2.002 billion.

Our commercial mortgage banking business provides guarantees related to debt instruments owned by the guaranteed party. As of December 31, 2004, such arrangements carried a total guaranteed value of \$247 million, with remaining contractual maturities of up to 15 years. We anticipate the extinguishment of our obligation under these guarantees prior to maturity as we intend to aggregate and pool individual items for transfer to substitute guarantors. These guarantees are secured by rights to properties valued at \$323 million as of December 31, 2004. As of December 31, 2004, we have accrued liabilities of \$7 million representing unearned fees on these guarantees.

We write credit default swaps requiring payment of principal due in exchange for the referenced credits, depending on the nature or occurrence of specified credit events for the referenced entities. In the event of a specified credit event, our maximum amount at risk, assuming the value of the referenced credits become worthless, is \$628 million as of December 31, 2004. The credit default swaps generally have maturities of five years or less.

In connection with certain acquisitions, we agreed to pay additional consideration in future periods, based upon the attainment by the acquired entity of defined operating objectives. In accordance with GAAP, we do not accrue contingent consideration obligations prior to the attainment of the objectives. As of December 31, 2004, maximum potential future consideration pursuant to such arrangements, to be resolved over the following five years, is \$344 million. Any such payments would result in increases in intangible assets, including goodwill.

We are also subject to other financial guarantees and indemnity arrangements. We have provided indemnities and guarantees related to acquisitions, dispositions, investments or other transactions that are triggered by, among other things, breaches of representations, warranties or covenants provided by us. These obligations are typically subject to various time limitations, defined by the contract or by operation of law, such as statutes of limitation. In some cases, the maximum potential obligation is subject to contractual limitations, while in other cases such limitations are not specified or applicable. Since certain of these obligations are not subject to limitations, it is not possible to determine the maximum potential amount due under these guarantees. As of December 31, 2004, we have accrued liabilities of \$13 million associated with all other financial guarantees and indemnity arrangements.

Other Contingent Commitments

In connection with our commercial mortgage banking business, we originate commercial mortgage loans. As of December 31, 2004, we had outstanding commercial mortgage loan commitments with borrowers of \$1.350 billion. In certain of these transactions, we prearrange that we will sell the loan to an investor after we fund the loan. As of December 31, 2004, \$494 million of our commitments to originate commercial mortgage loans are subject to such arrangements.

We also have other commitments, some of which are contingent upon events or circumstances not under our control, including those at the discretion of our counterparties. These other commitments amounted to \$4.067 billion as of December 31, 2004. Reflected in these other commitments are \$3.971 billion of commitments to purchase or fund investments, including \$2.932 billion that we anticipate will be funded from the assets of our separate accounts.

Other Off-Balance Sheet Arrangements

We do not have retained or contingent interests in assets transferred to unconsolidated entities, or variable interests in unconsolidated entities or other similar transactions, arrangements or relationships that serve as credit, liquidity or market risk support, that we believe are reasonably likely to have a material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or our access to or requirements for capital resources. In addition, we do not have relationships with any unconsolidated entities that are contractually limited to narrow activities that facilitate our transfer of or access to assets.

Deferred Policy Acquisition Costs

We capitalize costs that vary with and are related primarily to the production of new insurance and annuity business. These costs include commissions, costs to issue and underwrite the policies and certain variable field office expenses. The capitalized amounts are known as deferred policy acquisition costs, or DAC. Our total DAC, including the impact of unrealized investment gains and losses, amounted to \$8.8 billion and \$7.8 billion as of December 31, 2004 and 2003, respectively. As of December 31, 2004, approximately 46% of our total DAC relates to our Individual Life and Annuities segment, approximately 40% relates to our International Insurance segment and approximately 14% relates to our Closed Block Business.

If we were to experience a significant decrease in asset values or increase in lapse or surrender rates on policies for which we amortize DAC based on estimated gross margins or gross profits, such as participating and variable life insurance, we would expect acceleration of the amortization of DAC for the affected blocks of policies. Additionally, for all policies on which we have outstanding DAC, we would be required to evaluate whether this experience called into question our ability to recover all or a portion of the DAC, and we would be required to accelerate the amortization for some or all of the DAC if we concluded that we could not recover it. An accelerated amortization of DAC would negatively affect our reported earnings and level of capital under generally accepted accounting principles.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Risk Management, Market Risk and Derivative Instruments

Risk management includes the identification and measurement of various forms of risk, the establishment of risk thresholds and the creation of processes intended to maintain risks within these thresholds while optimizing returns on the underlying assets or liabilities. We consider risk management an integral part of our core business.

Market risk is the risk of change in the value of financial instruments as a result of absolute or relative changes in interest rates, foreign currency exchange rates or equity or commodity prices. To varying degrees, the investment and trading activities supporting all of our products and services generate market risks. The market risks incurred and our strategies for managing these risks vary by product.

With respect to non-variable life insurance products, fixed rate annuities, the fixed rate options in our variable life insurance and annuity products, consumer banking products, and other finance businesses, we incur market risk primarily in the form of interest rate risk. We manage this risk through asset/liability management strategies that seek to match the interest rate sensitivity of the assets to that of the underlying liabilities. Our overall objective in these strategies is to limit the net change in value of assets and liabilities arising from interest rate movements. While it is more difficult to measure the interest sensitivity of our insurance liabilities than that of the related assets, to the extent that we can measure such sensitivities we believe that interest rate movements will generate asset value changes that substantially offset changes in the value of the liabilities relating to the underlying products.

For variable annuities and variable life insurance products, excluding the fixed rate options in these products, mutual funds and most separate accounts, our main exposure to the market is the risk that asset management fees decrease as a result of declines in assets under management due to changes in prices of securities. We also run the risk that asset management fees calculated by reference to performance could be lower. For variable annuity and variable life insurance products with minimum guaranteed death and other benefits, we also face the risk that declines in the value of underlying investments as a result of changes in prices of securities may increase our net exposure to these death and other benefits under these contracts. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Results of Operations for Financial Services Businesses by Segment—Insurance Division—Individual Life and Annuities” for payments made under the guaranteed minimum death benefit provision of certain individual annuity contracts.

We manage our exposure to equity price risk relating to our general account investments primarily by seeking to match the risk profile of equity investments against risk-adjusted equity market benchmarks. We measure benchmark risk levels in terms of price volatility in relation to the market in general.

The sources of our exposure to market risk can be divided into two categories, “other than trading” activities conducted primarily in our insurance, annuity and guaranteed products operations, and “trading” activities conducted primarily in our equity and derivatives trading operations, as well as, historically, in our former domestic retail securities brokerage business. As part of our management of both “other than trading” and “trading” market risks, we use a variety of risk management tools and techniques. These include sensitivity and Value-at-Risk, or VaR, measures, position and other limits based on type of risk, and various hedging methods.

Other Than Trading Activities

We hold the majority of our assets for “other than trading” activities in our segments that offer insurance, annuities and guaranteed products. We incorporate asset/liability management techniques and other risk management policies and limits into the process of investing our assets. We use derivatives for hedging purposes in the asset/liability management process.

Insurance, Annuities and Guaranteed Products Asset/Liability Management

We seek to maintain interest rate and equity exposures within established ranges, which we periodically adjust based on market conditions and the design of related products sold to customers. Our risk managers establish investment risk limits for exposures to any issuer, geographic region, type of security or industry sector and oversee efforts to manage risk within policy constraints set by management and approved by the Investment Committee of the Board of Directors.

We use duration and convexity analyses to measure price sensitivity to interest rate changes. Duration measures the relative sensitivity of the fair value of a financial instrument to changes in interest rates. Convexity measures the rate of

change of duration with respect to changes in interest rates. We seek to manage our interest rate exposure by legal entity by matching the relative sensitivity of asset and liability values to interest rate changes, or controlling “duration mismatch” of assets and liabilities. We have target duration mismatch constraints for each entity. As of December 31, 2004 and 2003, the difference between the pre-tax duration of assets and the target duration of liabilities in our duration managed portfolios was within our constraint limits. We consider risk-based capital implications in our asset/liability management strategies.

We also perform portfolio stress testing as part of our regulatory cash flow testing. In this testing, we evaluate the impact of altering our interest-sensitive assumptions under various moderately adverse interest rate environments. These interest-sensitive assumptions relate to the timing and amount of redemptions and prepayments of fixed-income securities and lapses and surrenders of insurance products and the potential impact of any guaranteed minimum interest rates. We evaluate any shortfalls that this cash flow testing reveals to determine if we need to increase statutory reserves or adjust portfolio management strategies.

Market Risk Related to Interest Rates

Our “other than trading” assets that subject us to interest rate risk include primarily fixed maturity securities, commercial loans and policy loans. In the aggregate, the carrying value of these assets represented 69% of our consolidated assets, other than assets that we held in separate accounts, as of December 31, 2004 and 74% as of December 31, 2003.

With respect to “other than trading” liabilities, we are exposed to interest rate risk through policyholder account balances relating to interest-sensitive life insurance, annuity and investment-type contracts and through outstanding short-term and long-term debt.

We assess interest rate sensitivity for “other than trading” financial assets, financial liabilities and derivatives using hypothetical test scenarios that assume either upward or downward 100 basis point parallel shifts in the yield curve from prevailing interest rates. The following tables set forth the potential loss in fair value from a hypothetical 100 basis point upward shift as of December 31, 2004 and 2003, because this scenario results in the greatest net exposure to interest rate risk of the hypothetical scenarios tested at those dates. While the test scenario is for illustrative purposes only and does not reflect our expectations regarding future interest rates or the performance of fixed-income markets, it is a near-term, reasonably possible hypothetical change that illustrates the potential impact of such events. These test scenarios do not measure the changes in value that could result from non-parallel shifts in the yield curve, which we would expect to produce different changes in discount rates for different maturities. As a result, the actual loss in fair value from a 100 basis point change in interest rates could be different from that indicated by these calculations.

As of December 31, 2004			
Notional Value of Derivatives	Fair Value	Hypothetical Fair Value After + 100 Basis Point Parallel Yield Curve Shift	Hypothetical Change in Fair Value
(in millions)			
Financial assets with interest rate risk:			
Fixed maturities	\$165,298	\$155,335	\$(9,963)
Commercial loans	25,549	24,536	(1,013)
Mortgage broker-loan inventory	993	987	(6)
Policy loans	9,794	9,178	(616)
Derivatives:			
Swaps	\$16,443	(698)	(708)
Futures	2,202	4	(49)
Options	760	36	21
Forwards	12,718	(152)	(215)
Financial liabilities with interest rate risk:			
Short-term and long-term debt	(12,271)	(11,694)	577
Investment contracts	(64,064)	(62,738)	1,326
Net estimated potential loss			<u>\$(9,836)</u>

As of December 31, 2003				
	Notional Value of Derivatives	Fair Value	Hypothetical Fair Value After + 100 Basis Point Parallel Yield Curve Shift	Hypothetical Change in Fair Value
	(in millions)			
Financial assets with interest rate risk:				
Fixed maturities		\$132,027	\$123,866	\$(8,161)
Commercial loans		21,037	20,140	(897)
Mortgage broker-loan inventory		1,058	1,049	(9)
Policy loans		9,706	9,123	(583)
Derivatives:				
Swaps	\$11,231	(379)	(349)	30
Futures	2,148	1	(68)	(69)
Options	278	11	3	(8)
Forwards	12,791	(13)	(116)	(103)
Financial liabilities with interest rate risk:				
Short-term and long-term debt		(10,844)	(10,421)	423
Investment contracts		(41,450)	(40,865)	585
Net estimated potential loss				<u>\$(8,792)</u>

The tables above do not include approximately \$114.0 billion of insurance reserve and deposit liabilities as of December 31, 2004 and \$103.9 billion as of December 31, 2003. We believe that the interest rate sensitivities of these insurance liabilities offset, in large measure, the interest rate risk of the financial assets set forth in these tables.

The \$1.044 billion increase in the total estimated potential loss as of December 31, 2004 from December 31, 2003 resulted primarily from the increase in our portfolio of fixed maturities including those acquired as part of the purchase of the retirement business of CIGNA Corporation during 2004.

The estimated changes in fair values of our financial assets shown above relate primarily to assets invested to support our insurance liabilities, but do not include assets associated with products for which investment risk is borne primarily by the contractholders rather than by us.

Market Risk Related to Equity Prices

We actively manage investment equity price risk against benchmarks in respective markets. We benchmark our return on equity holdings against a blend of market indices, mainly the S&P 500 and Russell 2000, and we target price sensitivities that approximate those of the benchmark indices. We estimate our equity price risk from a hypothetical 10% decline in equity benchmark market levels and measure this risk in terms of the decline in fair market value of equity securities we hold. Using this methodology, our estimated equity price risk as of December 31, 2004 was \$473 million, representing a hypothetical decline in fair market value of equity securities we held at that date from \$4.732 billion to \$4.259 billion. Our estimated equity price risk using this methodology as of December 31, 2003 was \$340 million, representing a hypothetical decline in fair market value of equity securities we held at that date from \$3.401 billion to \$3.061 billion. In calculating these amounts, we exclude equity securities related to products for which the investment risk is borne primarily by the contractholder rather than by us. While these scenarios are for illustrative purposes only and do not reflect our expectations regarding future performance of equity markets or of our equity portfolio, they represent near term reasonably possible hypothetical changes that illustrate the potential impact of such events.

Market Risk Related to Foreign Currency Exchange Rates

We are exposed to foreign currency exchange rate risk in our general account investment portfolios and through our operations in foreign countries. In our international life insurance business, we generally invest in assets denominated in the same currencies as our insurance liabilities, which mitigates our foreign currency exchange rate risk for these operations.

Our exposure to foreign currency risk within the general account investment portfolios supporting our U.S. insurance operations arises primarily from purchased investments that are denominated or payable in foreign currencies. We generally hedge substantially all foreign currency-denominated fixed-income investments supporting our U.S. operations into U.S. dollars in order to mitigate the risk that the fair value of these investments fluctuates as a result of changes in foreign exchange rates. We generally do not hedge all of the foreign currency risk of our equity investments in unaffiliated foreign entities.

Our operations in foreign countries create two additional sources of foreign currency risk. First, we reflect the operating results of our foreign branches and subsidiaries in our financial statements based on the average exchange rates prevailing during the period. We hedge some of these foreign currency operating results as part of our overall risk management strategy. We generally hedge our anticipated exposure to adjusted operating income fluctuations resulting from changes in foreign currency exchange rates relating to our International operations primarily in Japan and Korea. Second, we translate our equity investment in foreign branches and subsidiaries into U.S. dollars using the foreign currency exchange rate at the financial statement period-end date. We have chosen to partially hedge this exposure.

We actively manage investment foreign currency exchange rate risk within specified limits at the consolidated level using VaR based analysis. This statistical technique estimates, at a specified confidence level, the potential pre-tax loss in portfolio market value that could occur over an assumed time horizon due to adverse market movements. We calculate this using a variance/covariance approach.

We calculate VaR estimates of exposure to loss from volatility in foreign currency exchange rates for one-month time periods. Our estimated VaR as of December 31, 2004 for foreign currency assets not hedged to U.S. dollars within our general account investment portfolios supporting our U.S. insurance operations, including the portion of equity investment in foreign subsidiaries not hedged, measured at the 95% confidence level and using a one-month time horizon, was \$35 million, representing a hypothetical decline in fair market value of these foreign currency assets from \$1.241 billion to \$1.206 billion. Our estimated VaR as of December 31, 2003 for foreign currency assets not hedged to U.S. dollars within our general account investment portfolios supporting our U.S. insurance operations, including the portion of equity investment in foreign subsidiaries not hedged, measured at the 95% confidence level and using a one-month time horizon, was \$24 million, representing a hypothetical decline in fair market value of these foreign currency assets from \$811 million to \$787 million. Our average monthly VaR for foreign currency assets not hedged to U.S. dollars within our general account investment portfolios supporting our U.S. insurance operations, including the portion of equity investment in foreign subsidiaries not hedged, from foreign currency exchange rate movements, measured at the 95% confidence level over a one month time horizon, was \$35 million during 2004 and \$18 million during 2003. These calculations use historical price volatilities and correlation data at a 95% confidence level. We discuss limitations of VaR models below.

Our estimated VaR for instruments used to hedge our anticipated exposure to adjusted operating income fluctuations resulting from changes in foreign currency exchange rates relating to our international operations, measured at the 95% confidence level and using a one-month time horizon, was \$110 million as of December 31, 2004 and \$59 million as of December 31, 2003.

Derivatives

Derivatives are financial instruments whose values are derived from interest rates, foreign exchange rates, financial indices, or the prices of securities or commodities. Derivative financial instruments may be exchange-traded or contracted in the over-the-counter market and include swaps, futures, options and forward contracts. See Note 19 to the Consolidated Financial Statements for a description of our derivative activities as of December 31, 2004 and 2003. Under insurance statutes, our insurance companies may use derivative financial instruments to hedge actual or anticipated changes in their assets or liabilities, to replicate cash market instruments or for certain income-generating activities. These statutes generally prohibit the use of derivatives for speculative purposes. We use derivative financial instruments primarily to seek to reduce market risk from changes in interest rates or foreign currency exchange rates, and to alter interest rate or foreign currency exposures arising from mismatches between assets and liabilities.

Trading Activities

We engage in trading activities primarily in connection with our equity and derivatives trading operations, as well as, historically, in our former domestic retail securities brokerage business. We maintain trading positions in various equity, foreign exchange instruments and commodities, primarily to facilitate transactions for our clients. Market risk affects the values of our trading positions through fluctuations in absolute or relative interest rates, foreign currency exchange rates, securities and commodity prices. We seek to use short security positions and forwards, futures, options and other derivatives to limit exposure to interest rate and other market risks. We also trade derivative financial instruments that allow our clients to manage exposure to interest rate, currency and other market risks. Our derivative transactions involve both exchange-listed and over-the-counter contracts and are generally short-term in duration. We act both as a broker, buying and selling exchange-listed contracts for our customers, and as a dealer, by entering into futures and security transactions as a principal. As a broker, we assume counterparty and credit risks that we seek to mitigate by using margin or other credit enhancements and by establishing trading limits and credit lines. As a dealer, we are subject to market risk as well as counterparty and

credit risk. We manage the market risk associated with trading activities through hedging activities and formal policies, risk and position limits, counterparty and credit limits, daily position monitoring, and other forms of risk management.

Value-at-Risk

VaR is one of the tools we use to monitor and manage our exposure to the market risk of our trading activities. We calculate a VaR that encompasses our trading activities using a 95% confidence level. The VaR method incorporates the risk factors to which the market value of our trading activities is exposed, which consist of interest rates, including credit spreads, foreign exchange rates, equity prices and commodity prices, estimates of volatilities from historical data, the sensitivity of our trading activities to changes in those market factors and the correlations of those factors. We test our VaR model by comparing actual adverse results to those estimated by the VaR model with a 95% confidence level over a one-day time horizon. The VaR for our trading activities expressed in terms of adverse changes to fair value at the 95% confidence level over a one-day time horizon was \$1 million as of December 31, 2004 and \$2 million as of December 31, 2003. The average daily VaR for our trading activities, expressed in terms of adverse changes to fair value with a 95% confidence level over a one-day time horizon, was \$1 million during 2004 and \$2 million during 2003. The following table sets forth a breakdown of this VaR by risk component as follows:

	As of December 31, 2004	Average for 2004	As of December 31, 2003	Average for 2003
	(in millions)			
Interest rate risk	\$—	\$—	\$ 1	\$ 2
Equity risk	—	—	—	—
Commodities risk	1	1	1	—
Total (1)	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$ 2</u>	<u>\$ 2</u>

(1) As of December 31, 2004 and 2003, and during the years then ended, VaR from foreign currency exchange rate risk in our trading activities was immaterial.

Limitations of VaR Models

Although VaR models are a recognized tool for risk management, they have inherent limitations, including reliance on historical data that may not be indicative of future market conditions or trading patterns. Accordingly, you should not view VaR models as a predictor of future results. We may incur losses that could be materially in excess of the amounts indicated by the models on a particular trading day or over a period of time, and there have been instances when results have fallen outside the values generated by our VaR models. A VaR model does not estimate the greatest possible loss. The results of these models and analysis thereof are subject to the judgment of our risk management personnel.

CONSOLIDATED FINANCIAL STATEMENTS

Management's Annual Report on Internal Control Over Financial Reporting

Management of Prudential Financial, Inc. (together with its consolidated subsidiaries, the "Company") is responsible for establishing and maintaining adequate internal control over financial reporting. Management conducted an assessment of the effectiveness, as of December 31, 2004, of the Company's internal control over financial reporting, based on the framework established in *Internal Control—Integrated Framework Issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)*. Based on our assessment under that framework, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2004.

Our internal control over financial reporting is a process designed by or under the supervision of our principal executive and principal financial officers to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of management and the directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on our financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements.

Management has excluded from the scope of its assessment the business of Aoba Life Insurance Company, Ltd., which the Company acquired during the fourth quarter of 2004. A discussion of this business, including its significance to the Company, is included in Note 3 to the consolidated financial statements of the Company included in this Annual Report.

Management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2004 has been audited by PricewaterhouseCoopers LLP, an independent registered accounting firm, as stated in their report accompanying the consolidated financial statements of the Company included in this Annual Report, which expresses unqualified opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting as of December 31, 2004.

March 8, 2005

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of
Prudential Financial, Inc.:

We have completed an integrated audit of Prudential Financial, Inc.'s 2004 consolidated financial statements and of its internal control over financial reporting as of December 31, 2004 and audits of its 2003 and 2002 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements

In our opinion, the accompanying consolidated statements of financial position and the related consolidated statements of operations, of stockholders' equity and of cash flows present fairly, in all material respects, the financial position of Prudential Financial, Inc. and its subsidiaries at December 31, 2004 and 2003 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The accompanying supplemental combining financial information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position and results of operations of the individual components. Such supplemental information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

As described in Notes 2 and 6 to the consolidated financial statements, the Company adopted American Institute of Certified Public Accountants Statement of Position 03-1, "Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts" as of January 1, 2004, Financial Accounting Standards Board revised Interpretation No. 46, "Consolidation of Variable Interest Entities" as of December 31, 2003, and the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" as of January 1, 2003.

Internal control over financial reporting

Also, in our opinion, management's assessment, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting, that the Company maintained effective internal control over financial reporting as of December 31, 2004 based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004, based on criteria established in *Internal Control—Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As described in Management's Annual Report on Internal Control Over Financial Reporting, management has excluded Aoba Life Insurance Company, Ltd. (Aoba Life) from its assessment of internal control over financial reporting as of December 31, 2004 because it was acquired by the Company in a purchase business combination during the fourth quarter of 2004. We have also excluded Aoba Life from our audit of internal control over financial reporting. Aoba Life is a wholly-owned subsidiary of the Company whose total assets represent less than 2% of the Company's consolidated total assets as of December 31, 2004.

A handwritten signature in cursive script that reads "PricewaterhouseCoopers LLP".

New York, NY
March 8, 2005

PRUDENTIAL FINANCIAL, INC.

**Consolidated Statements of Financial Position
December 31, 2004 and 2003 (in millions, except share amounts)**

	<u>2004</u>	<u>2003</u>
ASSETS		
Fixed maturities:		
Available for sale, at fair value (amortized cost: 2004—\$143,156; 2003—\$121,193)	\$150,968	\$128,943
Held to maturity, at amortized cost (fair value: 2004—\$2,765; 2003—\$3,084)	2,747	3,068
Trading account assets supporting insurance liabilities, at fair value	12,964	88
Other trading account assets, at fair value	1,547	3,214
Equity securities, available for sale, at fair value (cost: 2004—\$3,589; 2003—\$2,799)	4,283	3,401
Commercial loans	24,389	19,469
Policy loans	8,373	8,152
Securities purchased under agreements to resell	127	1,464
Other long-term investments	5,981	5,609
Short-term investments	5,245	7,633
Total investments	216,624	181,041
Cash and cash equivalents	8,072	7,949
Accrued investment income	2,028	1,797
Reinsurance recoverables	32,790	633
Deferred policy acquisition costs	8,847	7,826
Other assets	17,129	15,348
Separate account assets	115,568	106,680
TOTAL ASSETS	<u>\$401,058</u>	<u>\$321,274</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Future policy benefits	\$102,305	\$ 94,845
Policyholders' account balances	75,225	49,691
Unpaid claims and claim adjustment expenses	1,807	1,687
Policyholders' dividends	5,350	4,688
Reinsurance payables	32,386	180
Securities sold under agreements to repurchase	8,958	9,654
Cash collateral for loaned securities	7,269	5,786
Income taxes payable	2,681	2,282
Securities sold but not yet purchased	427	1,598
Short-term debt	4,044	4,739
Long-term debt	7,627	5,610
Other liabilities	15,067	12,542
Separate account liabilities	115,568	106,680
Total liabilities	378,714	299,982
COMMITMENTS AND CONTINGENCIES (See Note 21)		
STOCKHOLDERS' EQUITY		
Preferred Stock (\$.01 par value; 10,000,000 shares authorized; none issued)	—	—
Common Stock (\$.01 par value; 1,500,000,000 shares authorized; 604,894,558 and 584,590,320 shares issued at December 31, 2004 and 2003, respectively)	6	6
Class B Stock (\$.01 par value; 10,000,000 shares authorized; 2,000,000 shares issued and outstanding at December 31, 2004 and 2003, respectively)	—	—
Additional paid-in capital	20,354	19,560
Common Stock held in treasury, at cost (77,549,848 and 49,736,520 shares at December 31, 2004 and 2003, respectively)	(2,967)	(1,632)
Deferred compensation	(91)	(48)
Accumulated other comprehensive income	2,191	2,446
Retained earnings	2,851	960
Total stockholders' equity	22,344	21,292
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u>\$401,058</u>	<u>\$321,274</u>

See Notes to Consolidated Financial Statements

PRUDENTIAL FINANCIAL, INC.

Consolidated Statements of Operations

Years Ended December 31, 2004, 2003 and 2002 (in millions, except per share amounts)

	<u>2004</u>	<u>2003</u>	<u>2002</u>
REVENUES			
Premiums	\$12,580	\$13,233	\$ 13,053
Policy charges and fee income	2,317	2,001	1,780
Net investment income	9,079	8,680	8,818
Realized investment gains (losses), net	726	270	(1,365)
Commissions and other income	3,646	3,704	3,992
Total revenues	<u>28,348</u>	<u>27,888</u>	<u>26,278</u>
BENEFITS AND EXPENSES			
Policyholders' benefits	12,896	13,424	13,378
Interest credited to policyholders' account balances	2,334	1,830	1,846
Dividends to policyholders	2,485	2,602	2,644
General and administrative expenses	7,346	7,562	8,328
Loss on disposition of property and casualty insurance operations	—	491	—
Total benefits and expenses	<u>25,061</u>	<u>25,909</u>	<u>26,196</u>
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES, EXTRAORDINARY GAIN ON ACQUISITION AND CUMULATIVE EFFECT OF ACCOUNTING CHANGE	<u>3,287</u>	<u>1,979</u>	<u>82</u>
Income taxes:			
Current	601	169	(90)
Deferred	354	488	(98)
Total income tax expense (benefit)	<u>955</u>	<u>657</u>	<u>(188)</u>
INCOME FROM CONTINUING OPERATIONS BEFORE EXTRAORDINARY GAIN ON ACQUISITION AND CUMULATIVE EFFECT OF ACCOUNTING CHANGE	<u>2,332</u>	<u>1,322</u>	<u>270</u>
Loss from discontinued operations, net of taxes	(18)	(58)	(76)
Extraordinary gain on acquisition, net of taxes	21	—	—
Cumulative effect of accounting change, net of taxes	(79)	—	—
NET INCOME	<u><u>\$ 2,256</u></u>	<u><u>\$ 1,264</u></u>	<u><u>\$ 194</u></u>
EARNINGS PER SHARE (See Note 14)			
Financial Services Businesses			
Basic:			
Income from continuing operations before extraordinary gain on acquisition and cumulative effect of accounting change per share of Common Stock	\$ 3.52	\$ 2.10	\$ 1.38
Loss from discontinued operations	(0.03)	(0.11)	(0.13)
Extraordinary gain on acquisition, net of taxes	0.04	—	—
Cumulative effect of accounting change, net of taxes	(0.15)	—	—
Net income per share of Common Stock	<u><u>\$ 3.38</u></u>	<u><u>\$ 1.99</u></u>	<u><u>\$ 1.25</u></u>
Diluted:			
Income from continuing operations before extraordinary gain on acquisition and cumulative effect of accounting change per share of Common Stock	\$ 3.45	\$ 2.08	\$ 1.38
Loss from discontinued operations	(0.03)	(0.10)	(0.13)
Extraordinary gain on acquisition, net of taxes	0.04	—	—
Cumulative effect of accounting change, net of taxes	(0.15)	—	—
Net income per share of Common Stock	<u><u>\$ 3.31</u></u>	<u><u>\$ 1.98</u></u>	<u><u>\$ 1.25</u></u>
Dividends declared per share of Common Stock	<u><u>\$ 0.625</u></u>	<u><u>\$ 0.50</u></u>	<u><u>\$ 0.40</u></u>
Closed Block Business			
Net income (loss) per share of Class B Stock—basic and diluted	<u><u>\$249.00</u></u>	<u><u>\$ 89.50</u></u>	<u><u>\$(264.00)</u></u>
Dividends declared per share of Class B Stock	<u><u>\$ 9.625</u></u>	<u><u>\$ 9.625</u></u>	<u><u>\$ 9.625</u></u>

See Notes to Consolidated Financial Statements

PRUDENTIAL FINANCIAL, INC.

Consolidated Statements of Stockholders' Equity
Years Ended December 31, 2004, 2003 and 2002 (in millions)

	<u>Common Stock</u>		<u>Class B Stock</u>	<u>Additional Paid-in Capital</u>	<u>Retained Earnings (Deficit)</u>	<u>Common Stock Held in Treasury</u>	<u>Deferred Compensation</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Stockholders' Equity</u>
	<u>Shares</u>	<u>Amount</u>							
Balance, December 31, 2001	583.6	\$ 6	\$ —	\$19,462	\$ 41	\$ —	\$ —	\$ 944	\$20,453
Common Stock acquired	(26.0)	—	—	—	—	(800)	—	—	(800)
Stock-based compensation programs	1.7	—	—	4	—	57	(21)	—	40
Adjustments to policy credits issued and cash payments to eligible policyholders	0.9	—	—	47	—	—	—	—	47
Dividends declared on Common Stock	—	—	—	—	(226)	—	—	—	(226)
Dividends declared on Class B Stock	—	—	—	—	(19)	—	—	—	(19)
Comprehensive income:									
Net income	—	—	—	—	194	—	—	—	194
Other comprehensive income, net of tax	—	—	—	—	—	—	—	1,641	1,641
Total comprehensive income									1,835
Balance, December 31, 2002	560.2	6	—	19,513	(10)	(743)	(21)	2,585	21,330
Common Stock acquired	(29.1)	—	—	—	—	(1,001)	—	—	(1,001)
Stock-based compensation programs	3.7	—	—	40	(6)	112	(27)	—	119
Adjustments to policy credits issued and cash payments to eligible policyholders	0.1	—	—	7	—	—	—	—	7
Dividends declared on Common Stock	—	—	—	—	(269)	—	—	—	(269)
Dividends declared on Class B Stock	—	—	—	—	(19)	—	—	—	(19)
Comprehensive income:									
Net income	—	—	—	—	1,264	—	—	—	1,264
Other comprehensive loss, net of tax	—	—	—	—	—	—	—	(139)	(139)
Total comprehensive income									1,125
Balance, December 31, 2003	534.9	6	—	19,560	960	(1,632)	(48)	2,446	21,292
Common Stock issued	20.3	—	—	690	—	—	—	—	690
Common Stock acquired	(32.5)	—	—	—	—	(1,499)	—	—	(1,499)
Stock-based compensation programs	4.6	—	—	104	(14)	164	(43)	—	211
Dividends declared on Common Stock	—	—	—	—	(332)	—	—	—	(332)
Dividends declared on Class B Stock	—	—	—	—	(19)	—	—	—	(19)
Comprehensive income:									
Net income	—	—	—	—	2,256	—	—	—	2,256
Other comprehensive loss, net of tax	—	—	—	—	—	—	—	(255)	(255)
Total comprehensive income									2,001
Balance, December 31, 2004	<u>527.3</u>	<u>\$ 6</u>	<u>\$ —</u>	<u>\$20,354</u>	<u>\$2,851</u>	<u>\$(2,967)</u>	<u>\$ (91)</u>	<u>\$2,191</u>	<u>\$22,344</u>

See Notes to Consolidated Financial Statements

PRUDENTIAL FINANCIAL, INC.

Consolidated Statements of Cash Flows
Years Ended December 31, 2004, 2003 and 2002 (in millions)

	2004	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	\$ 2,256	\$ 1,264	\$ 194
Adjustments to reconcile net income to net cash provided by operating activities:			
Realized investment (gains) losses, net	(726)	(270)	1,365
Policy charges and fee income	(932)	(410)	(486)
Interest credited to policyholders' account balances	2,334	1,830	1,846
Depreciation and amortization, including premiums and discounts	589	714	559
Net loss on business dispositions	—	510	—
Change in:			
Deferred policy acquisition costs	(665)	(606)	(211)
Future policy benefits and other insurance liabilities	2,281	2,072	2,026
Trading account assets supporting insurance liabilities and other trading account assets	1,781	(560)	1,596
Income taxes payable	470	263	(205)
Securities sold but not yet purchased	(1,171)	(51)	(795)
Other, net	902	(3,972)	995
Cash flows from operating activities	7,119	784	6,884
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from the sale/maturity/prepayment of:			
Fixed maturities, available for sale	70,395	46,595	60,529
Fixed maturities, held to maturity	610	1,418	418
Equity securities, available for sale	2,251	1,355	2,050
Commercial loans	5,289	3,019	3,148
Other long-term investments	1,632	1,222	1,080
Short-term investments	22,197	20,133	15,434
Payments for the purchase of:			
Fixed maturities, available for sale	(81,833)	(47,919)	(71,539)
Fixed maturities, held to maturity	(211)	(1,816)	(2,701)
Equity securities, available for sale	(2,497)	(1,268)	(2,830)
Commercial loans	(3,910)	(2,473)	(2,543)
Other long-term investments	(904)	(804)	(1,357)
Short-term investments	(19,284)	(22,643)	(16,050)
Acquisition of subsidiaries, net of cash acquired	(1,082)	(946)	—
Cash of operations contributed to Wachovia Securities Financial Holdings, LLC	—	(229)	—
Proceeds from sale of subsidiaries, net of cash disposed	(76)	(45)	—
Cash flows used in investing activities	(7,423)	(4,401)	(14,361)
CASH FLOWS FROM FINANCING ACTIVITIES			
Policyholders' account deposits	14,385	10,091	8,973
Policyholders' account withdrawals	(14,197)	(9,402)	(7,464)
Net change in securities sold under agreements to repurchase and cash collateral for loaned securities	752	(1,555)	3,773
Proceeds from issuance of Common Stock	690	—	—
Cash dividends paid on Common Stock	(322)	(256)	(173)
Cash dividends paid on Class B Stock	(19)	(19)	(19)
Net change in debt (maturities 90 days or less)	(655)	4,104	(1,556)
Proceeds from deferred compensation program	—	—	56
Common Stock acquired	(1,493)	(1,007)	(782)
Common Stock reissued for exercise of stock options	107	53	1
Proceeds from the issuance of debt (maturities longer than 90 days)	3,717	2,897	1,346
Repayments of debt (maturities longer than 90 days)	(2,132)	(3,248)	(2,380)
Cash payments to or in respect of eligible policyholders	(327)	(147)	(2,569)
Cash flows from (used in) financing activities	506	1,511	(794)
Effect of foreign exchange rate changes on cash balances	(79)	157	(367)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	123	(1,949)	(8,638)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	7,949	9,898	18,536
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 8,072	\$ 7,949	\$ 9,898
SUPPLEMENTAL CASH FLOW INFORMATION			
Income taxes paid (received)	\$ (24)	\$ (84)	\$ 57
Interest paid	\$ 494	\$ 399	\$ 482

See Notes to Consolidated Financial Statements

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

1. BUSINESS

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. 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 9), 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.

Demutualization

On December 18, 2001 (the “date of demutualization”), the Prudential Insurance Company of America (“Prudential Insurance”) converted from a mutual life insurance company to a stock life insurance company and became an indirect, wholly owned subsidiary of Prudential Financial. At the time of demutualization Prudential Financial issued two classes of common stock both of which remain outstanding. The Common Stock, which is publicly traded, reflects the performance of the Financial Services Businesses and the Class B Stock, which was issued through a private placement, reflects the performance of the Closed Block Business.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements include the accounts of Prudential Financial, its majority-owned subsidiaries, as well as variable interest entities in which the Company is considered the primary beneficiary, and those partnerships and joint ventures in which the Company has a majority financial interest, except for those partnerships and joint ventures where the Company cannot exercise control because the minority owners have substantive participating rights in the operating and capital decisions of the entity. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). Intercompany balances and transactions have been eliminated.

The Company’s Gibraltar Life Insurance Company, Ltd. (“Gibraltar Life”) operations adopted a November 30 fiscal year end for purposes of inclusion in the Company’s Consolidated Financial Statements. Therefore the Consolidated Financial Statements as of December 31, 2004, and 2003, include Gibraltar Life’s assets and liabilities as of November 30, 2004 and 2003, respectively, and for the years ended December 31, 2004, 2003 and 2002, include Gibraltar life’s results of operations for the twelve months ended November 30, 2004, 2003 and 2002, respectively.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, in particular deferred policy acquisition costs, valuation of business acquired, investments, future policy benefits, provision for income taxes, disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

Earnings Per Share

As discussed in Note 1, the Company has outstanding two separate classes of common stock. Basic earnings per share is computed by dividing available income attributable to each of the two groups of common shareholders by the respective

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

weighted average number of common shares outstanding for the period. Diluted earnings per share includes the effect of all dilutive potential common shares that were outstanding during the period.

Stock Options

Effective January 1, 2003, the Company changed its accounting for employee stock options to adopt the fair value recognition provisions of Statement of Financial Accounting Standards (“SFAS”) No. 123, “Accounting for Stock-Based Compensation,” as amended, prospectively for all new awards 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 accounting method of SFAS No. 123 for the years ended December 31, 2004, 2003 and 2002, net income and earnings per share would have been as follows:

	Year ended December 31, 2004		Year ended December 31, 2003		Year ended December 31, 2002	
	Financial Services Businesses	Closed Block Business	Financial Services Businesses	Closed Block Business	Financial Services Businesses	Closed Block Business
	(in millions, except per share amounts)					
Net income (loss), as reported	\$1,674	\$ 582	\$1,025	\$ 239	\$ 679	\$ (485)
Add: Total employee stock option compensation expense included in reported net income, net of tax	19	—	10	—	—	—
Deduct: Total employee stock option compensation expense determined under the fair value based method for all awards, net of tax	45	1	45	1	30	—
Pro forma net income (loss)	<u>\$1,648</u>	<u>\$ 581</u>	<u>\$ 990</u>	<u>\$ 238</u>	<u>\$ 649</u>	<u>\$ (485)</u>
Earnings per share:						
Basic—as reported	3.38	249.00	1.99	89.50	1.25	(264.00)
Basic—pro forma	3.33	249.00	1.93	89.50	1.20	(264.00)
Diluted—as reported	3.31	249.00	1.98	89.50	1.25	(264.00)
Diluted—pro forma	3.26	249.00	1.91	89.50	1.20	(264.00)

The Company accounts for non-employee stock options using the fair value method of SFAS No. 123 in accordance with Emerging Issues Task Force Issue (“EITF”) No. 96-18 “Accounting for Equity Instruments That Are Issued to Other Than Employees” and related interpretations in accounting for its non-employee stock options.

In December 2004, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 123R, “Share-Based Payment,” which replaces FASB Statement No. 123, “Accounting for Stock-Based Compensation.” SFAS 123R 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. Under this method, compensation costs of awards to employees, such as stock options, are measured at fair value and expensed over the period during which an employee is required to provide service in exchange for the award (the vesting period). The Company had previously adopted the fair value recognition provisions of the original SFAS 123, prospectively for all new stock options issued to employees on or after January 1, 2003. SFAS 123R is effective for interim and annual periods beginning after June 15, 2005. The Company will adopt the fair value recognition provisions of this statement on July 1, 2005 for those awards issued prior to January 1, 2003. By that date, the unvested stock options issued prior to January 1, 2003 will have a compensation cost estimated to be \$2.8 million, which will be recognized over the remaining vesting period of approximately six months.

Investments

Fixed maturities are comprised of bonds, notes and redeemable preferred stock. Fixed maturities classified as “available for sale” are carried at fair value. Fixed maturities that the Company has both the positive intent and ability to hold to

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

maturity are stated at amortized cost and classified as “held to maturity.” The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization and accretion is included in “Net investment income.” The amortized cost of fixed maturities is written down to fair value when a decline in value is considered to be other than temporary. See the discussion below on realized investment gains and losses for a description of the accounting for impairments. Unrealized gains and losses on fixed maturities classified as “available for sale,” net of tax and the effect on deferred policy acquisition costs, valuation of business acquired, future policy benefits and policyholders’ dividends that would result from the realization of unrealized gains and losses, are included in a separate component of equity, “Accumulated other comprehensive income (loss).”

Investments for which fair value changes result in changes in experience-rated contractholder liabilities are classified as “trading” and included in “Trading account assets supporting insurance liabilities, at fair value.” All investment results, which include realized and unrealized gains and losses, as well as net investment income for these investments are reported in “Commissions and other income.”

“Other trading account assets, at fair value” and “Securities sold but not yet purchased” consist primarily of investments and derivatives used by the Company either in its capacity as a broker-dealer, its operation of hedge portfolios or its use of derivatives for asset and liability management activities. These instruments are carried at fair value. Realized and unrealized gains and losses on other trading account assets, securities sold but not yet purchased and the Company’s investments in its own separate accounts are included in “Commissions and other income.”

“Equity securities, available for sale” are comprised of common and non-redeemable preferred stock and are carried at fair value. The associated unrealized gains and losses, net of tax and the effect on deferred policy acquisition costs, valuation of business acquired, future policy benefits and policyholders’ dividends that would result from the realization of unrealized gains and losses, are included in “Accumulated other comprehensive income (loss).” The cost of equity securities is written down to fair value when a decline in value is considered to be other than temporary. See the discussion below on realized investment gains and losses for a description of the accounting for impairments.

Originated commercial loans are stated at unpaid principal balances, net of unamortized discounts and an allowance for losses. Interest income, including the amortization of the related discounts, is included in “Net investment income.” In connection with the acquisition of various businesses, commercial loans are recorded at fair value when acquired, with any premium or discount amortized over the remaining lives of the loans and included in “Net investment income.” The allowance for losses includes a loan specific reserve for non-performing loans and a portfolio reserve for probable incurred but not specifically identified losses. Non-performing loans include those loans for which it is probable that amounts due according to the contractual terms of the loan agreement will not all be collected. These loans are measured at the present value of expected future cash flows discounted at the loan’s effective interest rate, or at the fair value of the collateral if the loan is collateral dependent. Interest received on non-performing loans, including loans that were previously modified in a troubled debt restructuring, is either applied against the principal or reported as revenue, according to management’s judgment as to the collectibility of principal. Management discontinues accruing interest on non-performing loans after the loans are 90 days delinquent as to principal or interest, or earlier when management has serious doubts about collectibility. When a loan is recognized as non-performing, any accrued but uncollectible interest is charged to interest income in the period the loan is deemed non-performing. Generally, a loan is restored to accrual status only after all delinquent interest and principal are brought current and, in the case of loans where the payment of interest has been interrupted for a substantial period, a regular payment performance has been established. The portfolio reserve for incurred but not specifically identified losses considers the Company’s past loan loss experience, the current credit composition of the portfolio, historical credit migration, property type diversification, default and loss severity statistics and other relevant factors.

Policy loans are carried at unpaid principal balances.

Securities repurchase and resale agreements and securities borrowed and loaned transactions are used to generate income, to borrow funds, or to facilitate trading activity. Securities repurchase and resale agreements are generally short-term in nature, and therefore, the carrying amounts of these instruments approximate fair value. Securities repurchase and resale agreements are collateralized principally by U.S. government and government agency securities. Securities borrowed or loaned are collateralized principally by cash or U.S. government securities. For securities repurchase agreements and securities loaned transactions used to generate income, the cash received is typically invested in cash equivalents, short-term investments or fixed maturities.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Securities repurchase and resale agreements that satisfy certain criteria are treated as collateralized financing arrangements. These agreements are carried at the amounts at which the securities will be subsequently resold or reacquired, as specified in the respective agreements. For securities purchased under agreements to resell, the Company's policy is to take possession or control of the securities and to value the securities daily. Securities to be resold are the same, or substantially the same, as the securities received. For securities sold under agreements to repurchase, the market value of the securities to be repurchased is monitored, and additional collateral is obtained where appropriate, to protect against credit exposure. Securities to be repurchased are the same, or substantially the same, as those sold. Income and expenses related to these transactions executed within the general account, insurance and broker-dealer subsidiaries used to generate income are reported as "Net investment income;" however, for transactions used to borrow funds, the associated borrowing cost is reported as interest expense (included in "General and administrative expenses"). Income and expenses related to these transactions executed within our mortgage banking, derivative dealer and hedge portfolio operations are reported in "Commissions and other income."

Securities borrowed and securities loaned transactions are treated as financing arrangements and are recorded at the amount of cash advanced or received. With respect to securities loaned transactions, the Company obtains collateral in an amount equal to 102% and 105% of the fair value of the domestic and foreign securities, respectively. The Company monitors the market value of the securities borrowed and loaned on a daily basis with additional collateral obtained or provided as necessary. Substantially all of the Company's securities borrowed transactions are with brokers and dealers, commercial banks and institutional clients. Substantially all of the Company's securities loaned transactions are with large brokerage firms. Income and expenses associated with securities borrowed transactions are reported as "Net investment income." Income and expenses associated with securities loaned transactions used to generate income are generally reported as "Net investment income;" however, for securities loaned transactions used for funding purposes the associated rebate is reported as interest expense (included in "General and administrative expenses").

Other long-term investments consist of the Company's investments in joint ventures and limited partnerships in which the Company does not exercise control, other than our investment in Wachovia Securities Financial Holdings, LLC ("Wachovia Securities"), as well as investments in the Company's own separate accounts, which are carried at estimated fair value, and investment real estate. Joint venture and partnership interests are generally accounted for using the equity method of accounting, except in instances in which the Company's interest is so minor that it exercises virtually no influence over operating and financial policies. In such instances, the Company applies the cost method of accounting. The Company's net income from investments in joint ventures and partnerships, other than our investment in Wachovia Securities, is generally included in "Net investment income."

Real estate which the Company has the intent to hold for the production of income is carried at depreciated cost less any write-downs to fair value for impairment losses and is reviewed for impairment whenever events or circumstances indicate that the carrying value may not be recoverable. Real estate held for disposal is carried at the lower of depreciated cost or fair value less estimated selling costs and is not further depreciated once classified as such. An impairment loss is recognized when the carrying value of the investment real estate exceeds the estimated undiscounted future cash flows (excluding interest charges) from the investment. At that time, the carrying value of the investment real estate is written down to fair value. Decreases in the carrying value of investment real estate and impairments are recorded in "Realized investment gains (losses), net." Depreciation on real estate held for the production of income is computed using the straight-line method over the estimated lives of the properties, and is included in "Net investment income."

"Short-term investments" consists of highly liquid debt instruments with a maturity of greater than three months and less than twelve months when purchased. These investments are carried at amortized cost which, because of their short term, approximates fair value.

Realized investment gains (losses), net are computed using the specific identification method. Costs of fixed maturities and equity securities are adjusted for impairments, which are declines in value that are considered to be other than temporary. Impairment adjustments are included in "Realized investment gains (losses), net." In evaluating whether a decline in value is other than temporary, the Company considers several factors including, but not limited to the following: (1) the extent (generally if greater than 20%) and the duration (generally if greater than six months) of the decline; (2) the reasons for the decline in value (credit event, interest related or market fluctuation); (3) the Company's ability and intent to hold the

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

investment for a period of time to allow for a recovery of value; and (4) the financial condition of and near-term prospects of the issuer. Provisions for losses on commercial loans are included in "Realized investment gains (losses), net."

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, amounts due from banks, money market instruments and other debt instruments with maturities of three months or less when purchased.

Reinsurance Recoverables and Payables

Reinsurance recoverables and payables primarily include receivables and corresponding payables associated with the modified coinsurance arrangements used to effect the Company's acquisition of the retirement businesses of CIGNA Corporation ("CIGNA"). The reinsurance recoverables and the reinsurance payables associated with this acquisition are each \$32.2 billion at December 31, 2004. See Note 3 for additional information about these arrangements. The remaining amounts relate to reinsurance ceded and assumed arrangements entered into by the Company.

Deferred Policy Acquisition Costs

The costs that vary with and that are related primarily to the production of new insurance and annuity business are deferred to the extent such costs are deemed recoverable from future profits. Such costs include commissions, costs of policy issuance and underwriting, and variable field office expenses. Deferred policy acquisition costs ("DAC") are subject to recoverability testing at the end of each accounting period. DAC, for applicable products, is adjusted for the impact of unrealized gains or losses on investments as if these gains or losses had been realized, with corresponding credits or charges included in "Accumulated other comprehensive income (loss)."

For participating life insurance included in the Closed Block, DAC is amortized over the expected life of the contracts (up to 45 years) in proportion to estimated gross margins based on historical and anticipated future experience, which is evaluated regularly. The average rate per annum of assumed future investment yield used in estimating expected gross margins was 7.35% at December 31, 2004 and gradually increases to 8.06% for periods after December 31, 2031. The effect of changes in estimated gross margins on unamortized deferred acquisition costs is reflected in "General and administrative expenses" in the period such estimated gross margins are revised. Policy acquisition costs related to interest-sensitive and variable life products and certain investment-type products are deferred and amortized over the expected life of the contracts (periods ranging from 7 to 30 years) in proportion to estimated gross profits arising principally from investment results, mortality and expense margins, and surrender charges based on historical and anticipated future experience, which is updated periodically. The effect of changes to estimated gross profits on unamortized deferred acquisition costs is reflected in "General and administrative expenses" in the period such estimated gross profits are revised. DAC related to non-participating traditional individual life insurance is amortized over the expected life of the contracts in proportion to gross premiums.

The Company has offered programs under which policyholders, for a selected product or group of products, can exchange an existing policy or contract issued by the Company for another form of policy or contract. These transactions are known as internal replacements. If policyholders surrender traditional life insurance policies in exchange for life insurance policies that do not have fixed and guaranteed terms, the Company immediately charges to expense an estimate of the remaining unamortized DAC on the surrendered policies. For other internal replacement transactions, the unamortized DAC on the surrendered policies is immediately charged to expense if the terms of the new policies are not substantially similar to those of the former policies. If the new policies have terms that are substantially similar to those of the earlier policies, the DAC is retained with respect to the new policies and amortized over the expected life of the new policies.

For group annuity defined contribution contracts and funding agreement notes, acquisition expenses are deferred and amortized over the expected life of the contracts in proportion to estimated gross profits. For group and individual long-term care contracts, acquisition expenses are deferred and amortized over the expected life of the contracts in proportion to gross premiums. For other group life and disability insurance, group annuities and guaranteed investment contracts, acquisition costs are expensed as incurred.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Separate Account Assets and Liabilities

Separate account assets and liabilities are reported at fair value and represent segregated funds which are invested for certain policyholders, pension funds and other customers. The assets consist of common stocks, fixed maturities, real estate related investments, real estate mortgage loans and short-term investments. The assets of each account are legally segregated and are generally not subject to claims that arise out of any other business of the Company. Investment risks associated with market value changes are borne by the customers, except to the extent of minimum guarantees made by the Company with respect to certain accounts. See Note 8 for additional information regarding separate account arrangements with contractual guarantees. The investment income and gains or losses for separate accounts generally accrue to the policyholders and are not included in the Consolidated Statements of Operations. Mortality, policy administration and surrender charges assessed against the accounts are included in "Policy charges and fee income." Asset management fees charged to the accounts are included in "Commissions and other income."

Other Assets and Other Liabilities

Other assets consist primarily of prepaid benefit costs, certain restricted assets, broker-dealer related receivables, trade receivables, valuation of business acquired (described below), goodwill and other intangible assets, the Company's investment in Wachovia Securities, mortgage brokerage-loan inventory, property and equipment, and receivables resulting from sales of securities that had not yet settled at the balance sheet date. Commercial mortgage loans and other securities sold by the Company in securitization transactions for the years ended December 31, 2004, 2003 and 2002, were \$1,793 million, \$1,179 million and \$615 million, respectively. In some of the commercial loan securitizations, the Company retained servicing responsibilities, but did not retain any material ownership interest in the financial assets that were transferred. The Company recognized pre-tax gains of \$35 million, \$19 million and \$18 million for the years ended December 31, 2004, 2003 and 2002, respectively, in connection with securitization transactions, which are recorded in "Commissions and other income." Property and equipment are carried at cost less accumulated depreciation. Depreciation is determined using the straight-line method over the estimated useful lives of the related assets which generally range from 3 to 40 years. Other liabilities consist primarily of trade payables, broker-dealer related payables, employee benefit liabilities, demutualization consideration not yet paid to policyholders and payables resulting from purchases of securities that had not yet settled at the balance sheet date.

As a result of certain acquisitions and the application of purchase accounting, the Company reports a financial asset representing the valuation of business acquired ("VOBA"). VOBA represents the present value of future profits embedded in acquired insurance, annuity and investment-type contracts. VOBA is determined by estimating the net present value of future cash flows from the contracts in force at the date of acquisition. For acquired traditional insurance contracts, future positive cash flows generally include premiums while future negative cash flows include policyholders' benefits and certain maintenance expenses. For acquired annuity contracts, future positive cash flows generally include fees and other charges assessed to the contracts as long as they remain in force as well as fees collected upon surrender, if applicable, while future negative cash flows include costs to administer contracts and benefit payments. Future cash flows with respect to the acquired Skandia U.S. business include the impact of future cash flows expected from the guaranteed minimum death benefit provisions of the acquired contracts. For acquired investment-type contracts, future positive cash flows include investment spreads, and fees and other charges assessed to the contracts for as long as they remain in force, while future negative cash flows include costs to administer the contracts and taxes. Contract balances, from which the cash flows arise, are projected using assumptions for add-on deposits, participant withdrawals, contract surrenders, and investment returns. VOBA is further explicitly adjusted to reflect the cost associated with the capital invested in the business. The Company amortizes VOBA over the effective life of the acquired contracts. For acquired traditional insurance contracts, VOBA is amortized in proportion to gross premiums or in proportion to the face amount of insurance in force, as applicable. For acquired annuity contracts, VOBA is amortized in proportion to estimated gross profits arising from the contracts and anticipated future experience, which is evaluated regularly. For acquired investment-type contracts, VOBA is amortized in proportion to estimated gross profits arising principally from fees in excess of actual expense based upon historical and estimated future experience, which is updated periodically. The effect of changes in estimated gross profits on unamortized VOBA is reflected in "General and administrative expenses" in the period such estimates of expected future profits are revised.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Future Policy Benefits

The Company's liability for future policy benefits is primarily comprised of the present value of estimated future payments to or on behalf of policyholders, where the timing and amount of payment depends on policyholder mortality, less the present value of future net premiums. For traditional participating life insurance products, the mortality and interest rate assumptions applied are those used to calculate the policies' guaranteed cash surrender values. For life insurance, other than traditional participating life insurance, and annuity products, expected mortality is generally based on the Company's historical experience or standard industry tables. Interest rate assumptions are based on factors such as market conditions and expected investment returns. Although mortality and interest rate assumptions are "locked-in" upon the issuance of new insurance or annuity business with fixed and guaranteed terms, significant changes in experience or assumptions may require the Company to provide for expected future losses on a product by establishing premium deficiency reserves. The Company's liability for future policy benefits is also inclusive of liabilities for guarantee benefits related to certain nontraditional long-duration life and annuity contracts, which are discussed more fully in Note 8.

Policyholders' Account Balances

The Company's liability for policyholders' account balances represents the contract value that has accrued to the benefit of the policyholder as of the balance sheet date. This liability is generally equal to the accumulated account deposits, plus interest credited, less policyholder withdrawals and other charges assessed against the account balance. These policyholders' account balances also include provision for benefits under non-life contingent payout annuities.

Unpaid Claims and Claims Adjustments Expenses

The Company does not establish loss reserves until a loss has occurred. However, unpaid claims and claim adjustment expenses includes estimates of claims that the Company believes have been incurred but have not yet been reported ("IBNR") as of the balance sheet date. These IBNR estimates, and estimates of the amounts of loss the Company will ultimately incur on reported claims, which are based in part on historical experience, are adjusted as appropriate to reflect actual claims experience. When actual experience differs from the previous estimate, the resulting difference will be included in the reported results for the period of the change in estimate in the "Policyholders' benefits" caption. On an ongoing basis, trends in actual experience are a significant factor in the determination of claim reserve levels.

Policyholders' Dividends

The Company's liability for policyholders' dividends includes its dividends payable to policyholders and its policyholder dividend obligation associated with the participating policies included in the Closed Block established in connection with the Company's demutualization. The dividends payable for participating policies included in the Closed Block are determined at the end of each year for the following year by the Board of Directors of Prudential Insurance based on its statutory results, capital position, ratings, and the emerging experience of the Closed Block. The policyholder dividend obligation represents net unrealized investment gains that have arisen subsequent to the establishment of the Closed Block. The dividends payable for policies other than the participating policies included in the Closed Block include extraordinary dividends to certain policyholders of Gibraltar Life, a Japanese insurance company acquired in April 2001 and dividends payable in accordance with certain group insurance policies. The extraordinary dividends payable to the policyholders of Gibraltar Life are based on 70% of net realized investment gains, if any, over the value of real estate and loans included in Gibraltar Life's reorganization plan, net of transaction costs and taxes. As of December 31, 2004, this dividend liability is \$975 million.

Contingencies

Amounts related to contingencies are accrued if it is probable that a liability has been incurred and an amount is reasonably estimable. Management evaluates whether there are incremental legal or other costs directly associated with the ultimate resolution of the matter that are reasonably estimable and, if so, they are included in the accrual.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Insurance Revenue and Expense Recognition

Premiums from life insurance policies, excluding interest-sensitive life contracts, are recognized when due. When premiums are due over a significantly shorter period than the period over which benefits are provided, any excess profit is deferred and recognized into income in a constant relationship to insurance in force. Benefits are recorded as an expense when they are incurred. A liability for future policy benefits is recorded when premiums are recognized using the net level premium method.

Premiums from non-participating group annuities with life contingencies, structured settlements with life contingencies and single premium immediate annuities with life contingencies are recognized when received. Benefits are recorded as an expense when they are incurred. When premiums are due over a significantly shorter period than the period over which benefits are provided, a liability for future policy benefits is recorded when premiums are recognized using the net level premium method and any gross premium in excess of the net premium is deferred and recognized into income in a constant relationship to the amount of expected future policy benefit payments.

Certain annuity contracts provide the holder a guarantee that the benefit received upon death will be no less than a minimum prescribed amount that is based upon a combination of net deposits to the contract, net deposits to the contract accumulated at a specified rate or the highest historical account value on a contract anniversary. These contracts are discussed in further detail in Note 8. Also, as more fully discussed in Note 8, the liability for the guaranteed minimum death benefit under these contracts is determined each period end by estimating the accumulated value of a percentage of the total assessments to date less the accumulated value of death benefits in excess of the account balance.

Amounts received as payment for interest-sensitive life contracts, deferred annuities, structured settlements and other contracts without life contingencies, and participating group annuities are reported as deposits to "Policyholders' account balances." Revenues from these contracts are reflected in "Policy charges and fee income," or as a reduction of "Interest credited to policyholders' account balances," and consist primarily of fees assessed during the period against the policyholders' account balances for mortality charges, policy administration charges and surrender charges. Benefits and expenses for these products include claims in excess of related account balances, expenses of contract administration, interest credited and amortization of DAC.

For group life and disability insurance, and property and casualty insurance, premiums are recognized over the period to which the premiums relate in proportion to the amount of insurance protection provided. Claim and claim adjustment expenses are recognized when incurred.

Premiums, benefits and expenses are stated net of reinsurance ceded to other companies. Estimated reinsurance recoverables and the cost of reinsurance are recognized over the life of the reinsured policies using assumptions consistent with those used to account for the underlying policies.

Foreign Currency Translation Adjustments

Assets and liabilities of foreign operations and subsidiaries reported in currencies other than U.S. dollars are translated at the exchange rate in effect at the end of the period. Revenues, benefits and other expenses are translated at the average rate prevailing during the period. The effects of translating the statements of financial position of non-U.S. entities with functional currencies other than the U.S. dollar are included, net of related hedge gains and losses and income taxes, in "Accumulated other comprehensive income (loss)."

Commissions and Other Income

Commissions and other income principally include asset management fees and securities and commodities commission revenues which are recognized in the period in which the services are performed, as well as earnings from our investment in Wachovia Securities. Realized and unrealized gains and net investment income from investments classified as "Trading account assets supporting insurance liabilities" and "Other trading account assets" are also included in "Commissions and other income."

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Derivative Financial Instruments

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

Derivatives are used in a non-dealer capacity in our insurance, investment and international businesses as well as our treasury operations to manage the characteristics of the Company's asset/liability mix, manage the interest rate and currency characteristics of assets or liabilities and to mitigate the risk of a diminution, upon translation to U.S. dollars, of expected non-U.S. earnings and net investments in foreign operations resulting from unfavorable changes in currency exchange rates. Additionally, derivatives may be used to seek to reduce exposure to interest rate and foreign currency risks associated with assets held or expected to be purchased or sold, and liabilities incurred or expected to be incurred.

Derivatives are also used in a derivative dealer or broker capacity in the Company's securities operations to meet the needs of clients by structuring transactions that allow clients to manage their exposure to interest rates, foreign exchange rates, indices or prices of securities and commodities and similarly in a dealer or broker capacity through the operation of hedge portfolios in a limited-purpose subsidiary. Realized and unrealized changes in fair value of derivatives used in these dealer related operations as well as derivatives used in the mortgage banking business are included in "Commissions and other income" in the periods in which the changes occur. Cash flows from such derivatives are reported in the operating activities section of the Consolidated Statements of Cash Flows.

Derivatives are recorded either as assets, within "Other trading account assets," "Other assets," or "Other long-term investments," or as liabilities, within "Other liabilities." As discussed in detail below and in Note 19, all realized and unrealized changes in fair value of non-dealer related derivatives, with the exception of the effective unrealized portion of cash flow hedges and effective hedges of net investments in foreign operations, are recorded in current earnings. Cash flows from these derivatives are reported in the operating or investing activities section in the Consolidated Statements of Cash Flows.

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

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

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

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

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

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

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

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

The Company is a party to financial instruments that may contain derivative instruments that are "embedded" in the financial instruments. At inception, the Company assesses whether the economic characteristics of the embedded derivative are clearly and closely related to the economic characteristics of the remaining component of the financial instrument (*i.e.*, the host contract) and whether a separate instrument with the same terms as the embedded instrument would meet the definition of a derivative instrument. When it is determined that (1) the embedded derivative possesses economic characteristics that are not clearly and closely related to the economic characteristics of the host contract, and (2) a separate instrument with the same terms would qualify as a derivative instrument, the embedded derivative is separated from the host contract, carried at fair value, and changes in its fair value are included in "Realized investment gains (losses), net."

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

When hedge accounting is discontinued because the hedged item no longer meets the definition of a firm commitment, or because it is probable that the forecasted transaction will not occur by the end of the specified time period, the derivative will continue to be carried on the balance sheet at its fair value, with changes in fair value recognized currently in "Realized investment gains (losses), net." Any asset or liability that was recorded pursuant to recognition of the firm commitment is removed from the balance sheet and recognized currently in "Realized investment gains (losses), net." Gains and losses that were in "Accumulated other comprehensive income (loss)" pursuant to the hedge of a forecasted transaction are recognized immediately in "Realized investment gains (losses), net."

In its mortgage operations, the Company enters into commitments to fund commercial mortgage loans at specified interest rates and other applicable terms within specified periods of time. These commitments are legally binding agreements to extend credit to a counterparty. Loan commitments for loans that will be held for sale, are recognized as derivatives and recorded at fair value. Beginning in 2004, as a result of Securities and Exchange Commission Staff Accounting Bulletin 105 ("SAB 105"), "Application of Accounting Principles to Loan Commitments," in recording such commitments at fair value the Company no longer recognizes: 1) the initial fair value for those loan commitments where the Company does not have a corresponding investor purchase commitment for the resulting loan; and 2) the fair value of the future mortgage servicing right ("MSR") related to the resulting loan. However, subsequent changes in fair value on loan commitments for loans that will be held for sale, exclusive of MSR value, are included in "Commissions and Other Income." and recognized as derivative assets or liabilities. Upon funding of the related loan, the carrying amount of the loan commitment is included in the initial basis of the loan. The impact of adopting the provisions of SAB 105 did not have a material impact on the

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Company's financial condition or results of operations. The determination of the estimated fair value of loan commitments accounted for as derivatives considers various factors including, among others, terms of the related loan, the intended exit strategy for the loans based upon either a securitization pricing model or investor purchase commitments, prevailing interest rates, and origination income or expense. Loan commitments that relate to the origination of mortgage loans that will be held for investment are not accounted for as derivatives and accordingly are not recognized in the Company's financial statements.

Income Taxes

The Company and its eligible domestic subsidiaries file a consolidated federal income tax return that includes both life insurance companies and non-life insurance companies. Subsidiaries operating outside the U.S. are taxed, and income tax expense is recorded, based on applicable foreign statutes. See Note 17 for a discussion of certain non-U.S. jurisdictions for which the Company assumes repatriation of earnings to the U.S.

Deferred income taxes are recognized, based on enacted rates, when assets and liabilities have different values for financial statement and tax reporting purposes. A valuation allowance is recorded to reduce a deferred tax asset to the amount expected to be realized.

New Accounting Pronouncements

In March 2004, the EITF of the FASB reached a final consensus on Issue 03-1, "The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments." This Issue establishes impairment models for determining whether to record impairment losses associated with investments in certain equity and debt securities. 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's policy is generally to record income only as cash is received following an impairment of a debt security. In September 2004, the FASB issued FASB Staff Position ("FSP") EITF 03-1-1, which defers the effective date of a substantial portion of EITF 03-1, from the third quarter of 2004, as originally required by the EITF, until such time as FASB issues further implementation guidance, which is expected sometime in 2005. The Company will continue to monitor developments concerning this Issue and is currently unable to estimate the potential effects of implementing EITF 03-1 on the Company's consolidated financial position or results of operations.

In January 2004 and May 2004, the FASB issued FSP 106-1 and 106-2, each of which is entitled "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement, and Modernization Act of 2003," respectively. See Note 16 for details regarding the adoption of these pronouncements.

In December 2003, the FASB issued FIN No. 46(R), "Consolidation of Variable Interest Entities," which revised the original FIN No. 46 guidance issued in January 2003. FIN No. 46(R) addresses whether certain types of entities, referred to as variable interest entities ("VIEs"), should be consolidated in a company's financial statements. A VIE is an entity that either (1) has equity investors that lack certain essential characteristics of a controlling financial interest (including the ability to control the entity, the obligation to absorb the entity's expected losses and the right to receive the entity's expected residual returns) or (2) lacks sufficient equity to finance its own activities without financial support provided by other entities, which in turn would be expected to absorb at least some of the expected losses of the VIE. An entity should consolidate a VIE if, as the primary beneficiary, it stands to absorb a majority of the VIE's expected losses or to receive a majority of the VIE's expected residual returns. On December 31, 2003, the Company adopted FIN No. 46(R) for all special purpose entities ("SPEs") and for relationships with all VIEs that began on or after February 1, 2003. On March 31, 2004, the Company implemented FIN No. 46(R) for relationships with potential VIEs that are not SPEs. The transition to FIN No. 46(R) did not have a material effect on the Company's consolidated financial position or results of operations.

In July 2003, the Accounting Standards Executive Committee ("AcSEC") of the American Institute of Certified Public Accountants ("AICPA") issued Statement of Position ("SOP") 03-1, "Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts." AcSEC issued this SOP to address the need for

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

interpretive guidance in three areas: separate account presentation and valuation; the classification and valuation of certain long-duration contract liabilities; and the accounting recognition given sales inducements (bonus interest, bonus credits and persistency bonuses).

The Company adopted SOP 03-1 effective January 1, 2004. One element of this guidance addressed the accounting for liabilities related to insurance products that provide contractholders with a return based on a contractually referenced pool of investments. Effective with the adoption of SOP 03-1, the contractholder liabilities associated with these products are required to be adjusted for changes in the fair value of the related pool of investments. These products pass the economics related to the referenced pool of investments to the contractholder.

The effect of adopting SOP 03-1 was a charge of \$79 million, net of \$44 million of taxes, which was reported as a "Cumulative effect of accounting change, net of taxes" in the results of operations for the year ended December 31, 2004. This charge reflects the net impact of converting large group annuity contracts and certain individual market value adjusted annuity contracts from separate account accounting treatment to general account accounting treatment, including carrying the related liabilities at accreted value, and the effect of establishing reserves for guaranteed minimum death benefit provisions of the Company's variable annuity and variable life contracts. The Company also recognized a cumulative effect of accounting change related to unrealized investment gains within "Other comprehensive income, net of taxes" of \$73 million, net of \$42 million of taxes, for the year ended December 31, 2004. Upon adoption of SOP 03-1, \$3.3 billion in "Separate account assets" were reclassified resulting in a \$2.8 billion increase in "Fixed maturities, available for sale" and a \$0.6 billion increase in "Trading account assets supporting insurance liabilities, at fair value," as well as changes in other non-separate account assets. Similarly, upon adoption, \$3.3 billion in "Separate account liabilities" were reclassified resulting in increases in "Policyholders' account balances" and "Future policy benefits," as well as changes in other non-separate account liabilities.

In June 2004, the FASB issued FSP No. 97-1, "Situations in Which Paragraphs 17(b) and 20 of FASB Statement No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments, Permit or Require Accrual of an Unearned Revenue Liability." FSP 97-1 clarifies the accounting for unearned revenue liabilities of certain universal-life type contracts under SOP 03-1. The Company's adoption of FSP 97-1 on July 1, 2004 did not change the accounting for unearned revenue liabilities and, therefore, had no impact on the Company's consolidated financial position or results of operations. In September 2004, the AICPA SOP 03-1 Implementation Task Force issued a Technical Practice Aid ("TPA") to clarify certain aspects of SOP 03-1. The Company is currently evaluating the effect of the implementation of this TPA in its international insurance operations on the Company's consolidated financial position or results of operations.

In April 2003, the FASB issued Statement No. 133 Implementation Issue No. B36, "Embedded Derivatives: Modified Coinsurance Arrangements and Debt Instruments That Incorporate Credit Risk Exposures That Are Unrelated or Only Partially Related to the Creditworthiness of the Obligor Under Those Instruments." Implementation Issue No. B36 indicates that a modified coinsurance arrangement ("modco"), in which funds are withheld by the ceding insurer and a return on those withheld funds is paid based on the ceding company's return on certain of its investments, generally contains an embedded derivative feature that is not clearly and closely related to the host contract and should be bifurcated in accordance with the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." Effective October 1, 2003, the Company adopted the guidance prospectively for existing contracts and all future transactions. As permitted by SFAS No. 133, all contracts entered into prior to January 1, 1999, were grandfathered and are exempt from the provisions of SFAS No. 133 that relate to embedded derivatives. The application of Implementation Issue No. B36 in 2003 had no impact on the consolidated financial position or results of operations of the Company.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 generally applies to instruments that are mandatorily redeemable, that represent obligations that will be settled with a variable number of company shares, or that represent an obligation to purchase a fixed number of company shares. For instruments within its scope, the statement requires classification as a liability with initial measurement at fair value. Subsequent measurement depends upon the certainty of the terms of the settlement (such as amount and timing) and whether the obligation will be settled by a transfer of assets or by issuance of a fixed or variable

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

number of equity shares. The Company's adoption of SFAS No. 150, as of July 1, 2003, did not have a material effect on the Company's consolidated financial position or results of operations.

In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 requires that a liability for costs associated with an exit or disposal activity be recognized and measured initially at fair value only when the liability is incurred. Prior to the adoption of SFAS No. 146, such amounts were recorded upon the Company's commitment to a restructuring plan. The Company has adopted this statement for applicable transactions occurring on or after January 1, 2003.

In November 2002, the FASB issued FIN No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." FIN No. 45 expands existing accounting guidance and disclosure requirements for certain guarantees and requires the recognition of a liability for the fair value of certain types of guarantees issued or modified after December 31, 2002. The January 1, 2003 adoption of the Interpretation's guidance did not have a material effect on the Company's financial position.

Reclassifications

Certain amounts in prior years have been reclassified to conform to the current year presentation.

3. ACQUISITIONS AND DISPOSITIONS

Acquisition of Aoba Life Insurance Company, Ltd.

On November 1, 2004, the Company acquired Aoba Life Insurance Company, Ltd. ("Aoba Life") for \$191 million of total consideration from Tawa S.A., a subsidiary of Artemis S.A. Aoba Life is a Japanese life insurer with a run-off book of insurance and is not selling new policies. The Company is in the process of integrating this business into its existing international insurance operations. The Statement of Financial Position of the Company as of December 31, 2004, includes assets and liabilities of \$6.4 billion and \$6.2 billion, respectively, from the acquisition of Aoba Life. Pro forma information for this acquisition is omitted as the impact is not material.

Acquisition of CIGNA Corporation's Retirement Business

On April 1, 2004, the Company purchased the retirement business of CIGNA for \$2.123 billion, including \$2.103 billion of cash consideration and \$20 million of transaction costs. The assets acquired and liabilities assumed and the results of operations have been included in the Company's consolidated financial statements as of that date. The acquisition of this business included the purchase by the Company of all the shares of CIGNA Life Insurance Company ("CIGNA Life"), which became an indirect wholly owned subsidiary of the Company. Prior to the acquisition, CIGNA Life entered into reinsurance arrangements with CIGNA to effect the transfer of the retirement business included in the transaction to CIGNA Life. Subsequent to its acquisition, the Company changed the name of CIGNA Life to Prudential Retirement Insurance and Annuity Company ("PRIAC").

The reinsurance arrangements between PRIAC and CIGNA include coinsurance-with-assumption, modified-coinsurance-with-assumption, and modified-coinsurance-without-assumption.

The coinsurance-with-assumption arrangement applies to the acquired general account defined contribution and defined benefit plan contracts. Prior to the acquisition, CIGNA Life assumed from CIGNA all of the insurance liabilities associated with these contracts, totaling \$15.9 billion, and received from CIGNA the related investments. PRIAC has established a trust account for the benefit of CIGNA to secure its obligations to CIGNA under the coinsurance agreement. The Company is in the process of requesting the pension plan customers to agree to substitute PRIAC for CIGNA in their respective contracts, and expects this process to be substantially complete by the end of 2005.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

3. ACQUISITIONS AND DISPOSITIONS (continued)

The modified-coinsurance-with-assumption arrangements apply to the majority of separate account contracts, and the general account defined benefit guaranteed-cost contracts acquired. Under the modified coinsurance arrangement associated with the separate account contracts, CIGNA retains the separate account and other assets as well as the related separate account and other liabilities until the agreed upon dates of asset transfer but, beginning on the date of acquisition, cedes all of the net profits or losses and related net cash flows associated with the contracts to PRIAC. At the date of acquisition, the statement of financial position for PRIAC includes a reinsurance receivable of \$32.4 billion and reinsurance payable of \$32.4 billion established under these modified coinsurance arrangements and reflected in "Reinsurance recoverables" and "Reinsurance payables," respectively. At the agreed upon dates of asset transfer, PRIAC will assume the separate account and other insurance liabilities and concurrently will receive from CIGNA the associated separate account and other assets. The Company expects the assumption of these liabilities and the concurrent asset transfer to be substantially complete by early 2005.

The modified-coinsurance-with-assumption arrangement associated with the general account defined benefit guaranteed-cost contracts is similar to the arrangement associated with the separate account contracts; however, beginning two years after the acquisition, the Company may commute this modified coinsurance arrangement in exchange for cash consideration from CIGNA, at which time PRIAC would no longer have a related liability and the defined benefit guaranteed cost contracts would remain with CIGNA. If PRIAC does not commute the modified coinsurance arrangement, this arrangement will convert to a coinsurance-with-assumption arrangement. After the conversion, this coinsurance arrangement will be similar to the arrangement associated with the defined contribution and defined benefit pension plan contracts described above. At the date of acquisition, PRIAC established a reinsurance receivable of \$1.8 billion and a reinsurance payable of \$1.8 billion under the modified coinsurance arrangement, which are reflected in "Reinsurance recoverables" and "Reinsurance payables," respectively. The net profits earned by PRIAC during the two-year period that the modified coinsurance arrangement is in effect are included in "Commissions and other income."

The modified-coinsurance-without-assumption arrangement applies to the remaining separate account contracts acquired and is similar to the modified coinsurance arrangement associated with the separate account contracts described above; however, CIGNA will retain the separate account and other assets and the related liabilities while ceding the net profits or losses and the associated net cash flows to PRIAC for the remaining lives of the contracts. At the date of acquisition, PRIAC established a reinsurance receivable of \$1.0 billion and a reinsurance payable of \$1.0 billion for this modified coinsurance arrangement, which are reflected in "Reinsurance recoverables" and "Reinsurance payables," respectively.

The following table presents an allocation of the purchase price to assets acquired and liabilities assumed:

	(in millions)
Total invested assets at fair value(1)	\$ 17,103
Cash and cash equivalents	45
Accrued investment income	181
Valuation of business acquired ("VOBA")	423
Goodwill	564
Reinsurance recoverable(2)	35,184
Other assets	202
Separate account assets	25
Total assets acquired	<u>53,727</u>
Future policy benefits—assumed	(9)
Policyholders' account balances—assumed	(15,871)
Reinsurance payable(2)	(35,184)
Other liabilities	(515)
Separate account liabilities	(25)
Total liabilities assumed	<u>(51,604)</u>
Net assets acquired	<u>\$ 2,123</u>

(1) Total invested assets include \$11.1 billion of "Trading account assets supporting insurance liabilities," which is primarily comprised of fixed maturities.

(2) The reinsurance recoverable and reinsurance payable amounts represent amounts receivable and payable under the modified coinsurance arrangements described above.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

3. ACQUISITIONS AND DISPOSITIONS (continued)

Goodwill is the excess of the cost of an acquired entity over the net amounts assigned to assets acquired and liabilities assumed. Goodwill resulting from the acquisition of CIGNA's retirement business amounted to \$564 million, of which the Company currently estimates 100% to be deductible for tax purposes. In accordance with GAAP, goodwill will not be amortized but rather will be tested at least annually for impairment. The goodwill associated with this acquisition is reflected as \$445 million in the Retirement segment, and as \$119 million in the Asset Management segment.

The following supplemental information presents selected unaudited pro forma information for the Company assuming the acquisition had occurred as of January 1, 2003. This pro forma information does not purport to represent what the Company's actual results of operations would have been if the acquisition had occurred as of the dates indicated or what such results would be for any future periods.

	Years ended December 31,	
	2004	2003
	(in millions, except per share data, unaudited)	
Total revenues	\$28,888	\$29,534
Income from continuing operations before extraordinary gain on acquisition and cumulative effect of accounting change	2,356	1,547
Net income	2,145	1,489
Earnings per share:		
Financial Services Businesses:		
Income from continuing operations before extraordinary gain on acquisition and cumulative effect of accounting change per share of Common Stock		
Basic	\$ 3.57	\$ 2.51
Diluted	3.50	2.49
Net income per share of Common Stock		
Basic	\$ 3.16	\$ 2.41
Diluted	3.10	2.39
Closed Block Business:		
Income from continuing operations before extraordinary gain on acquisition and cumulative effect of accounting change per share of Class B Stock		
Basic and diluted	\$249.00	\$ 89.50
Net income per share of Class B Stock		
Basic and diluted	\$249.00	\$ 89.50

Acquisition of Hyundai Investment and Securities Co., Ltd.

On February 27, 2004, the Company completed the acquisition of an 80% interest in Hyundai Investment and Securities Co., Ltd. and its subsidiary Hyundai Investment Trust Management Co., Ltd. (together "Hyundai") from the Korean Deposit Insurance Corporation ("KDIC"), an agency of the Korean government for \$301 million in cash, including \$210 million used to repay debt assumed. The Company may choose to acquire, or be required to acquire, from the KDIC the remaining 20% of Hyundai three to six years after closing. Subsequent to the acquisition, the Company was renamed Prudential Investment & Securities Co., Ltd. Pro forma information for this acquisition is omitted as the impact is not material.

The Company has completed its purchase accounting for the transaction, which resulted in a \$21 million extraordinary gain as the fair value of the assets acquired of \$2.4 billion less the fair value of liabilities assumed of \$2.3 billion exceeded the purchase price. In addition, at the date of acquisition the Company recorded approximately \$1.5 billion of "Other trading account assets" and approximately \$1.5 billion of "Other liabilities" associated with certain special purposes entities related to Hyundai (the "Hyundai SPEs"), that the Company consolidated in accordance with FIN No. 46(R). In the fourth quarter of 2004 the Company stopped consolidating the Hyundai SPEs, as the KDIC assumed all the rights and obligations of the Hyundai SPEs. There are no income taxes associated with the extraordinary gain based on the assumption that foreign investment and subsequent earnings are not to be repatriated to the U.S. The Company's Consolidated Statement of

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

3. ACQUISITIONS AND DISPOSITIONS (continued)

Operations for the year ended December 31, 2004, includes the operating results of Hyundai from the date of acquisition. "Commissions and other income" for 2004 include \$20 million of fees due from the Korean government under the terms of the transaction.

Acquisition of Skandia U.S. Inc.

On May 1, 2003, the Company acquired Skandia U.S. Inc. ("Skandia U.S."), a wholly owned subsidiary of Skandia Insurance Company Ltd. ("Skandia"). The Company purchased newly issued shares of common stock representing 90% of the outstanding common stock of Skandia U.S. and one share of a newly issued class of preferred stock (collectively the "Shares") and entered into an agreement at the date of acquisition whereby the Company had the right to acquire, and Skandia had the right to require the Company to acquire, the remaining 10% of outstanding common stock. This agreement was accounted for as a financing transaction until the Company purchased the remaining 10% in the third quarter of 2003. The Company's acquisition of Skandia U.S. included American Skandia, Inc. ("American Skandia"), which is one of the largest distributors of variable annuities through independent financial planners in the U.S. The acquisition also included a mutual fund business.

Effective May 1, 2003, 100% of the assets acquired and liabilities assumed and the results of operations have been included in the Company's consolidated financial statements. The total purchase price was as follows:

	(in millions)
Purchase price paid for the Shares(a)	\$ 646
Assumption of collateralized notes held by third parties	248
Purchase price for the remaining 10% equity of Skandia U.S.	165
Other payments to Skandia(b)	115
Transaction costs	10
Total purchase price(c)	<u>\$1,184</u>

The following table represents an allocation of the purchase price to assets acquired and liabilities assumed:

	(in millions)
Total investments at market value	\$ 486
Cash and cash equivalents	238
Valuation of business acquired ("VOBA")	425
Other assets at fair value	408
Separate account assets	<u>22,311</u>
Total assets acquired	<u>23,868</u>
Policyholders' account balances	(168)
Other liabilities at fair value	(205)
Separate account liabilities	<u>(22,311)</u>
Total liabilities assumed	<u>(22,684)</u>
Net assets acquired(c)	<u>\$ 1,184</u>

- (a) The proceeds were used by Skandia U.S. to retire an aggregate of \$646 million of unsecured debt and collateralized notes held by Skandia.
- (b) Prior to the Company's acquisition of Skandia U.S., Skandia acquired certain subsidiaries of Skandia U.S. The cash Skandia paid to Skandia U.S. for these subsidiaries has been repaid to Skandia and is considered a component of the purchase price.
- (c) In May 2003, subsequent to the Company's acquisition of Skandia U.S., Skandia U.S. paid a dividend to Prudential Financial of approximately \$108 million, reducing the equity of Skandia U.S. by that amount.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

3. ACQUISITIONS AND DISPOSITIONS (continued)

The following table presents selected unaudited pro forma financial information of the Company for the periods ended December 31, 2003 and 2002, assuming that the Skandia U.S. acquisition had occurred January 1, 2002. This pro forma information does not purport to represent what the Company's actual results of operations would have been if the acquisition had occurred as of the date indicated or what such results would be for any future periods.

	Years ended December 31,	
	2003	2002
	(in millions, except per share data, unaudited)	
Total revenues	\$28,030	\$ 26,843
Income from continuing operations before extraordinary gain on acquisition and cumulative effect of accounting change	1,335	387
Net income	1,277	311
Earnings per share:		
Financial Services Businesses:		
Income from continuing operations before extraordinary gain on acquisition and cumulative effect of accounting change per share of Common Stock		
Basic	\$ 2.12	\$ 1.58
Diluted	2.11	1.58
Net income per share of Common Stock		
Basic	\$ 2.02	\$ 1.45
Diluted	2.00	1.45
Closed Block Business:		
Income (loss) from continuing operations before extraordinary gain on acquisition and cumulative effect of accounting change per share of Common Stock		
Basic and diluted	\$ 89.50	\$(264.00)
Net income (loss) per share of Class B Stock		
Basic and diluted	\$ 89.50	\$(264.00)

Investment in Wachovia Securities

On July 1, 2003, the Company completed the combination of its retail securities brokerage and clearing operations with those of Wachovia Corporation ("Wachovia") to form a joint venture, Wachovia Securities. The Company has a 38% ownership interest in the joint venture, while Wachovia owns the remaining 62%. The transaction included certain assets and liabilities of the Company's securities brokerage operations but did not include its equity sales, trading and research operations. As part of the transaction, the Company retained certain assets and liabilities related to the contributed businesses, including liabilities for certain litigation and regulatory matters. The Company and Wachovia have each agreed to indemnify the other for certain losses, including losses resulting from litigation and regulatory matters relating to certain events arising from the operations of their respective contributed businesses prior to March 31, 2004. The Company accounts for its 38% ownership of the joint venture under the equity method of accounting; periods prior to July 1, 2003, continue to reflect the results of the Company's previously wholly owned securities brokerage operations on a fully consolidated basis.

At any time after July 1, 2005 and on or prior to July 1, 2008, the Company may, subject to certain limitations, require Wachovia to purchase its interests in Wachovia Securities for a price generally equal to the Company's initial \$1.0 billion equity contribution plus its share of transition costs, as adjusted to reflect additional investments made by the Company. At any time after July 1, 2008, the Company may, subject to certain limitations, require Wachovia to purchase its interests in Wachovia Securities for a price generally equal to the Company's share of the then appraised value of the common equity of the organization, determined as if it were a public company and including a control premium such as would apply in the case of a sale of 100% of its common equity. The agreement between Prudential Financial and Wachovia also gives the Company put rights, and Wachovia call rights, in certain other specified circumstances, at prices determined in accordance with the agreement.

Results for the year ended December 31, 2003, include a pre-tax gain of \$22 million from the combination of the businesses.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

3. ACQUISITIONS AND DISPOSITIONS (continued)

The Company recognized pre-tax equity earnings from Wachovia Securities of \$58 million and \$56 million for the years ended December 31, 2004 and 2003, respectively. The pre-tax equity earnings from Wachovia Securities are included in "Commissions and other income." The Company's investment in Wachovia Securities was \$1.1 billion as of December 31, 2004 and 2003, and is included in "Other assets."

In connection with the combination, the Company entered into various agreements with Wachovia and Wachovia Securities, including one associated with certain money market mutual fund balances of brokerage clients of Wachovia Securities, for which our results of operations include revenues of \$28 million and \$79 million for the years ended December 31, 2004 and 2003, respectively. These balances were essentially eliminated as of September 30, 2004 due to the replacement of those funds with other investment alternatives for those brokerage clients. The resulting reduction in asset management fees has been offset by payments from Wachovia under an agreement dated as of July 30, 2004 implementing arrangements with respect to money market mutual funds in connection with the combination. The agreement extends for ten years after termination of the joint venture with Wachovia. The revenue from Wachovia under this agreement was \$35 million in 2004.

Discontinued Operations

Income (loss) from discontinued businesses, including charges upon disposition, for the years ended December 31, are as follows:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
	(in millions)		
International securities operations(a)	\$(42)	\$ (97)	\$(71)
Web-based workplace distribution of voluntary benefits(b)	—	—	(58)
Healthcare operations(c)	6	11	71
Property and casualty operations(d)	(2)	(28)	(32)
Other(e)	(7)	(13)	3
Loss from discontinued operations before income taxes	(45)	(127)	(87)
Income tax benefit	(27)	(69)	(11)
Loss from discontinued operations, net of taxes	<u>\$(18)</u>	<u>\$ (58)</u>	<u>\$(76)</u>

The Company's Consolidated Statements of Financial Position include total assets and total liabilities related to discontinued businesses of \$141 million and \$114 million, respectively, at December 31, 2004 and \$1,531 million and \$1,209 million, respectively, at December 31, 2003.

- (a) International securities operations include the European retail transaction-oriented stockbrokerage and related activities of Prudential Securities Group Inc. The loss for the discontinued businesses for the years ended December 31, 2004, 2003 and 2002 include pre-tax charges of \$6 million, \$40 million and \$43 million, respectively, relating primarily to severance and termination benefits and office closure costs.
- (b) In the third quarter of 2002, the Company discontinued its web-based business for the workplace distribution of voluntary benefits. The loss for the year ended December 31, 2002 includes a pre-tax impairment charge of \$32 million on the Company's investment in a vendor of that distribution platform, as well as a pre-tax charge of \$7 million related to severance and contract termination costs.
- (c) The sale of the Company's healthcare business to Aetna was completed in 1999. The loss the Company previously recorded upon the disposal of its healthcare business was reduced in each of the years ended December 31, 2004, 2003 and 2002. The reductions were primarily the result of favorable resolution of certain legal, regulatory and contractual matters. Although the Company no longer issues or renews healthcare policies, it was required to issue and renew policies for specified periods of time after the closing date, in order to provide for uninterrupted operation and growth of the business that Aetna acquired. All such policies were 100% coinsured by Aetna.
- (d) This includes the results of the Company's specialty automobile and work-place distribution property and casualty insurance operations, which the Company sold in 2003 and 2004, respectively.
- (e) Other includes the results of consumer banking operations, which the Company exited in 2004, and retail broker-dealer operations in Tokyo, which the Company decided to sell in the fourth quarter of 2002.

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 results of operations of a particular quarterly or annual period.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

3. ACQUISITIONS AND DISPOSITIONS *(continued)*

Disposition of Other Property and Casualty Insurance Operations

In the fourth quarter of 2003, the Company completed the sale of its property and casualty insurance companies that operated nationally in 48 states outside of New Jersey, and the District of Columbia, to Liberty Mutual Group, as well as its New Jersey property and casualty insurance companies to Palisades Group. Results of these businesses are included in "Income from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change" for all periods. For the year ended December 31, 2003, the Company recognized a loss on disposition of \$491 million (\$319 million after taxes), recorded within "Loss from disposition of property and casualty insurance operations," which also includes management's best estimate of the cost of retained liabilities, including litigation pertaining to events before the closing and the estimated value of indemnification coverage provided in connection with potential adverse claim experience and a \$57 million abandonment and impairment loss recorded in connection with certain long-lived assets.

4. INVESTMENTS

Fixed Maturities and Equity Securities

The following tables provide information relating to fixed maturities and equity securities (excluding investments classified as trading) at December 31,

	2004			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in millions)			
Fixed maturities, available for sale				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 6,143	\$ 619	\$ 3	\$ 6,759
Obligations of U.S. states and their political subdivisions	2,241	247	4	2,484
Foreign government bonds	26,556	1,069	146	27,479
Corporate securities	98,234	6,252	401	104,085
Mortgage-backed securities	9,982	191	12	10,161
Total fixed maturities, available for sale	<u>\$143,156</u>	<u>\$8,378</u>	<u>\$566</u>	<u>\$150,968</u>
Equity securities, available for sale	<u>\$ 3,589</u>	<u>\$ 776</u>	<u>\$ 82</u>	<u>\$ 4,283</u>

	2004			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in millions)			
Fixed maturities, held to maturity				
Foreign government bonds	\$ 109	\$ —	\$ 4	\$ 105
Corporate securities	593	19	—	612
Mortgage-backed securities	2,045	20	17	2,048
Total fixed maturities, held to maturity	<u>\$ 2,747</u>	<u>\$ 39</u>	<u>\$ 21</u>	<u>\$ 2,765</u>

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

4. INVESTMENTS (continued)

	2003			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in millions)			
Fixed maturities, available for sale				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 7,023	\$ 439	\$ 30	\$ 7,432
Obligations of U.S. states and their political subdivisions	1,815	178	8	1,985
Foreign government bonds	24,167	1,072	91	25,148
Corporate securities	84,443	6,412	331	90,524
Mortgage-backed securities	3,745	116	7	3,854
Total fixed maturities, available for sale	<u>\$121,193</u>	<u>\$8,217</u>	<u>\$467</u>	<u>\$128,943</u>
Equity securities, available for sale	<u>\$ 2,799</u>	<u>\$ 691</u>	<u>\$ 89</u>	<u>\$ 3,401</u>

	2003			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in millions)			
Fixed maturities, held to maturity				
Foreign government bonds	\$ 163	\$ 2	\$ 3	\$ 162
Corporate securities	312	12	—	324
Mortgage-backed securities	2,593	28	23	2,598
Total fixed maturities, held to maturity	<u>\$ 3,068</u>	<u>\$ 42</u>	<u>\$ 26</u>	<u>\$ 3,084</u>

The amortized cost and fair value of fixed maturities by contractual maturities at December 31, 2004, is as follows:

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(in millions)		(in millions)	
Due in one year or less	\$ 8,780	\$ 8,859	\$ 29	\$ 29
Due after one year through five years	41,524	43,154	141	145
Due after five years through ten years	37,071	39,440	48	53
Due after ten years	45,799	49,354	484	490
Mortgage-backed securities	9,982	10,161	2,045	2,048
Total	<u>\$143,156</u>	<u>\$150,968</u>	<u>\$2,747</u>	<u>\$2,765</u>

Actual maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

The following table depicts the source of fixed maturity proceeds and related gross investment gains (losses) on trades and prepayments and losses on impairments of both fixed maturities and equity securities:

	2004	2003	2002
	(in millions)		
Fixed maturities, available for sale:			
Proceeds from sales	\$57,870	\$34,489	\$47,341
Proceeds from maturities/repayments	12,525	12,106	13,188
Gross investment gains from sales and prepayments	906	933	1,267
Gross investment losses from sales	(305)	(306)	(1,300)
Fixed maturities, held to maturity:			
Proceeds from maturities/repayments	\$ 610	\$ 1,418	\$ 418
Gross investment gains from prepayments	—	—	—
Fixed maturity and equity security impairments:			
Write-downs for impairments of fixed maturities	\$ (183)	\$ (389)	\$ (687)
Write-downs for impairments of equity securities	(18)	(160)	(309)

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

4. INVESTMENTS (continued)

Trading Account Assets Supporting Insurance Liabilities

“Trading account assets supporting insurance liabilities” is comprised of investments that support experience-rated contracts of the Company’s Retirement and International Insurance segments. These assets are classified as trading and are carried at fair value. All investment results, which include realized and unrealized gains and losses, as well as net investment income, for these investments are reported in “Commissions and other income.” The following table sets forth the composition of “Trading account assets supporting insurance liabilities” at December 31,

	2004		2003	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(in millions)		(in millions)	
Short-term investments, cash and cash equivalents	\$ 951	\$ 951	\$—	\$—
Fixed maturities:				
U.S. government corporations and agencies and obligations of				
U.S. states	311	306	3	3
Foreign government bonds	387	390	37	38
Corporate securities	9,483	9,378	17	15
Mortgage-backed securities	1,494	1,492	—	—
Total fixed maturities	11,675	11,566	57	56
Equity securities	378	447	32	32
Total trading account assets supporting insurance liabilities	<u>\$13,004</u>	<u>\$12,964</u>	<u>\$ 89</u>	<u>\$ 88</u>

At December 31, 2004, 67% of the portfolio was comprised of publicly traded securities, versus 100% of the portfolio as of December 31, 2003. As of December 31, 2004, 98% of the fixed maturity portion of the portfolio was investment grade investments, versus 100% of the fixed maturity portion of the portfolio as of December 31, 2003. The change in the net holding gain or loss on these securities during the years ended December 31, 2004 and 2003 was a loss of \$108 million and \$1 million, respectively.

Commercial Loans

The Company’s commercial loans are as follows at December 31,

	2004		2003	
	Amount (in millions)	% of Total	Amount (in millions)	% of Total
Collateralized loans by property type				
Office buildings	\$ 5,013	22.3%	\$ 3,355	18.8%
Retail stores	2,904	12.9%	1,739	9.8%
Residential properties	1,311	5.8%	2,058	11.5%
Apartment complexes	5,169	22.9%	4,642	26.1%
Industrial buildings	4,790	21.2%	3,379	19.0%
Agricultural properties	1,786	7.9%	1,864	10.5%
Other	1,581	7.0%	764	4.3%
Subtotal of collateralized loans	22,554	100.0%	17,801	100.0%
Valuation allowance	(159)		(160)	
Total collateralized loans	<u>22,395</u>		<u>17,641</u>	
Uncollateralized loans				
Uncollateralized loans	2,329		2,160	
Valuation allowance	(335)		(332)	
Total uncollateralized loans	<u>1,994</u>		<u>1,828</u>	
Net carrying value	<u>\$24,389</u>		<u>\$19,469</u>	

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

4. INVESTMENTS (continued)

The commercial loans are geographically dispersed throughout the United States, Canada and Asia with the largest concentrations in California (23%) and Asia (14%) at December 31, 2004.

Activity in the allowance for losses for all commercial loans, for the years ended December 31, is as follows:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
	(in millions)		
Allowance for losses, beginning of year	\$492	\$496	\$550
Release of allowance for losses	(12)	(34)	(33)
Charge-offs, net of recoveries	(8)	(7)	(39)
Change in foreign exchange	22	37	18
Allowance for losses, end of year	<u>\$494</u>	<u>\$492</u>	<u>\$496</u>

Non-performing commercial loans identified in management's specific review of probable loan losses and the related allowance for losses at December 31, are as follows:

	<u>2004</u>	<u>2003</u>
	(in millions)	
Non-performing commercial loans with allowance for losses	\$ 429	\$ 369
Non-performing commercial loans with no allowance for losses	120	120
Allowance for losses, end of year	(352)	(318)
Net carrying value of non-performing commercial loans	<u>\$ 197</u>	<u>\$ 171</u>

Non-performing commercial loans with no allowance for losses are loans in which the fair value of the collateral or the net present value of the loans' expected future cash flows equals or exceeds the recorded investment. The average recorded investment in non-performing loans before allowance for losses was \$523 million, \$542 million and \$631 million for 2004, 2003 and 2002, respectively. Net investment income recognized on these loans totaled \$18 million, \$14 million and \$27 million for the years ended December 31, 2004, 2003 and 2002, respectively.

Other Long-term Investments

"Other long-term investments" are comprised as follows:

	<u>2004</u>	<u>2003</u>
	(in millions)	
Joint venture and limited partnerships:		
Real estate related	\$ 509	\$ 368
Non real estate related	1,383	1,245
Total joint venture and limited partnerships	1,892	1,613
Real estate held through direct ownership	1,435	1,204
Separate accounts	1,361	1,273
Other	1,293	1,519
Total other long-term investments	<u>\$5,981</u>	<u>\$5,609</u>

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

4. INVESTMENTS (continued)

Equity Method Investments

Summarized combined financial information for joint ventures and limited partnership interests accounted for under the equity method, including our investment in Wachovia Securities, in which the Company has an investment of \$10 million or greater and an equity interest of 10% or greater, is as follows:

	At December 31,	
	2004	2003
	(in millions)	
STATEMENTS OF FINANCIAL POSITION		
Investments in real estate	\$ 2,755	\$ 2,540
Investments in securities	14,106	11,544
Cash and cash equivalents	928	878
Other assets	23,305	17,832
Total assets	\$41,094	\$32,794
Borrowed funds-third party	\$ 1,012	\$ 1,617
Borrowed funds-Prudential	532	460
Other liabilities	30,014	22,827
Total liabilities	31,558	24,904
Partners' capital	9,536	7,890
Total liabilities and partners' capital	\$41,094	\$32,794
Equity in partners' capital included above	\$ 2,764	\$ 2,486
Equity in limited partnership interests not included above	612	548
Carrying value	\$ 3,376	\$ 3,034

	Years ended December 31,		
	2004	2003	2002
	(in millions)		
STATEMENTS OF OPERATIONS			
Income from real estate investments	\$ 409	\$ 313	\$ 140
Income from securities investments	2,875	2,732	140
Interest expense-third party	(103)	(151)	(63)
Other expenses	(2,668)	(2,381)	(159)
Net earnings	\$ 513	\$ 513	\$ 58
Equity in net earnings included above	\$ 162	\$ 141	\$ 12
Equity in net earnings of limited partnership interests not included above	158	60	16
Total equity in net earnings	\$ 320	\$ 201	\$ 28

Net Investment Income

Net investment income for the years ended December 31, was from the following sources:

	2004	2003	2002
	(in millions)		
Fixed maturities, available for sale	\$6,647	\$6,308	\$6,344
Fixed maturities, held to maturity	110	117	80
Equity securities, available for sale	88	54	73
Commercial loans	1,507	1,368	1,416
Policy loans	463	497	529
Broker-dealer related receivables	52	95	259
Short-term investments and cash equivalents	179	182	312
Other investment income	646	606	504
Gross investment income	9,692	9,227	9,517
Less investment expenses	(613)	(547)	(699)
Net investment income	\$9,079	\$8,680	\$8,818

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

4. INVESTMENTS (continued)

Based on the carrying value, assets categorized as “non-income producing” at December 31, 2004 included in fixed maturities, commercial loans and other long-term investments totaled \$80 million, \$7 million and \$201 million, respectively.

Realized Investment Gains (Losses), Net

Realized investment gains (losses), net, for the years ended December 31, were from the following sources:

	2004	2003	2002
	(in millions)		
Fixed maturities	\$ 418	\$ 238	\$ (720)
Equity securities, available for sale	430	(10)	(335)
Commercial loans	11	81	48
Investment real estate	62	(22)	(7)
Joint ventures and limited partnerships	68	65	24
Derivatives	(264)	(167)	(400)
Other	1	85	25
Realized investment gains (losses), net	<u>\$ 726</u>	<u>\$ 270</u>	<u>\$ (1,365)</u>

Net Unrealized Investment Gains (Losses)

Net unrealized investment gains and losses on securities classified as “available for sale” and certain other long-term investments are included in the Consolidated Statements of Financial Position as a component of “Accumulated other comprehensive income (loss).” Changes in these amounts include reclassification adjustments to exclude from “Other comprehensive income (loss)” those items that are included as part of “Net income” for a period that had been part of “Other comprehensive income (loss)” in earlier periods. The amounts for the years ended December 31, are as follows:

	Net Unrealized Gains (Losses) On Investments	Deferred Policy Acquisition Costs and Valuation of Business Acquired	Future Policy Benefits	Policyholders’ Dividends	Deferred Income Tax (Liability) Benefit	Accumulated Other Comprehensive Income (Loss) Related To Net Unrealized Investment Gains (Losses)
	(in millions)					
Balance, December 31, 2001	\$2,372	\$(320)	\$ (77)	\$ —	\$ (747)	\$ 1,228
Net investment gains (losses) on investments arising during the period . .	4,019	—	—	—	(1,434)	2,585
Reclassification adjustment for (gains) losses included in net income . . .	1,055	—	—	—	(376)	679
Impact of net unrealized investment (gains) losses on deferred policy acquisition costs	—	(216)	—	—	78	(138)
Impact of net unrealized investment (gains) losses on future policy benefits	—	—	(769)	—	276	(493)
Impact of net unrealized investment (gains) losses on policyholders’ dividends	—	—	—	(1,606)	579	(1,027)
Balance, December 31, 2002	7,446	(536)	(846)	(1,606)	(1,624)	2,834
Net investment gains (losses) on investments arising during the period . .	1,164	—	—	—	(439)	725
Reclassification adjustment for (gains) losses included in net income . . .	(368)	—	—	—	139	(229)
Impact of net unrealized investment (gains) losses on deferred policy acquisition costs	—	103	—	—	(37)	66
Impact of net unrealized investment (gains) losses on future policy benefits	—	—	(446)	—	161	(285)
Impact of net unrealized investment (gains) losses on policyholders’ dividends	—	—	—	(837)	301	(536)
Balance, December 31, 2003	8,242	(433)	(1,292)	(2,443)	(1,499)	2,575
Net investment gains (losses) on investments arising during the period . .	791	—	—	—	(127)	664
Reclassification adjustment for (gains) losses included in net income . . .	(805)	—	—	—	282	(523)
Impact of net unrealized investment (gains) losses on deferred policy acquisition costs and valuation of business acquired	—	83	—	—	(33)	50
Impact of net unrealized investment (gains) losses on future policy benefits	—	—	(502)	—	162	(340)
Impact of net unrealized investment (gains) losses on policyholders’ dividends	—	—	—	(698)	220	(478)
Cumulative effect of accounting change	137	(22)	—	—	(42)	73
Balance, December 31, 2004	<u>\$8,365</u>	<u>\$(372)</u>	<u>\$(1,794)</u>	<u>\$(3,141)</u>	<u>\$(1,037)</u>	<u>\$ 2,021</u>

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

4. INVESTMENTS (continued)

The table below presents unrealized gains (losses) on investments by asset class at December 31,

	<u>2004</u>	<u>2003</u>	<u>2002</u>
	(in millions)		
Fixed maturities	\$7,812	\$7,750	\$7,594
Equity securities	694	602	(42)
Other investments	(141)	(110)	(106)
Net unrealized gains on investments	<u>\$8,365</u>	<u>\$8,242</u>	<u>\$7,446</u>

Duration of Gross Unrealized Loss Positions for Fixed Maturities

The following table shows the fair value and gross unrealized losses aggregated by investment category and length of time that individual fixed maturity securities have been in a continuous unrealized loss position, at December 31:

2004					
Less than twelve months		Twelve months or more		Total	
Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(in millions)					
Fixed maturities(1)					
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 771	\$ 3	\$ 4	\$ —	\$ 775
Obligations of U.S. states and their political subdivisions	394	1	86	2	480
Foreign government bonds	2,852	37	1,355	113	4,207
Corporate securities	14,079	230	2,017	172	16,096
Mortgage-backed securities	2,503	15	621	14	3,124
Total	<u>\$20,599</u>	<u>\$286</u>	<u>\$4,083</u>	<u>\$301</u>	<u>\$24,682</u>
					<u>\$587</u>

(1) Includes \$1,259 million of fair value and \$21 million of gross unrealized losses at December 31, 2004 on securities classified as held to maturity, which are not reflected in accumulated other comprehensive income.

2003					
Less than twelve months		Twelve months or more		Total	
Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(in millions)					
Fixed maturities(1)					
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 1,642	\$ 34	\$ —	\$ —	\$ 1,642
Obligations of U.S. states and their political subdivisions	235	8	3	—	238
Foreign government bonds	2,703	91	54	2	2,757
Corporate securities	8,802	250	1,498	79	10,300
Mortgage-backed securities	2,309	29	—	—	2,309
Total	<u>\$15,691</u>	<u>\$412</u>	<u>\$1,555</u>	<u>\$ 81</u>	<u>\$17,246</u>
					<u>\$493</u>

(1) Includes \$1,617 million of fair value and \$26 million of gross unrealized losses at December 31, 2003 on securities classified as held to maturity, which are not reflected in accumulated other comprehensive income.

At December 31, 2004, gross unrealized losses on fixed maturities were \$587 million, compared to \$493 million at December 31, 2003. The gross unrealized losses at December 31, 2004 and 2003, are comprised of \$490 million and \$396

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

4. INVESTMENTS (continued)

million related to investment grade securities and \$97 million and \$97 million related to below investment grade securities, respectively. At December 31, 2004, \$3 million of the gross unrealized losses represented declines in value of greater than 20%, none of which had been in that position for twelve months or more, as compared to \$39 million at December 31, 2003 that represented declines in value of greater than 20%, substantially all of which had been in that position for less than six months. At December 31, 2004, the \$301 million of gross unrealized losses of twelve months or more were concentrated in the foreign government, finance and manufacturing sectors. At December 31, 2003, the \$81 million of gross unrealized losses of twelve months or more were concentrated in the retail, finance and manufacturing sectors. In accordance with its policy described in Note 2, the Company concluded that an adjustment for other than temporary impairments for these securities was not warranted at December 31, 2004 or 2003.

Duration of Gross Unrealized Loss Positions for Equity Securities

The following table shows the fair value and gross unrealized losses aggregated by length of time that individual equity securities have been in a continuous unrealized loss position, at December 31:

2004					
Less than twelve months		Twelve months or more		Total	
Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(in millions)					
Equity securities, available for sale	\$735	\$66	\$ 66	\$801	\$82
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
2003					
Less than twelve months		Twelve months or more		Total	
Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(in millions)					
Equity securities, available for sale	\$548	\$65	\$123	\$671	\$89
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>

At December 31, 2004, gross unrealized losses on equity securities were \$82 million, compared to \$89 million at December 31, 2003. At December 31, 2004, \$18 million of the gross unrealized losses represented declines of greater than 20%, substantially all of which had been in that position for less than six months. At December 31, 2003, \$8 million of the gross unrealized losses represented declines of greater than 20%, substantially all of which had been in that position for less than six months. In accordance with its policy described in Note 2, the Company concluded that an adjustment for other than temporary impairments for these securities was not warranted at December 31, 2004 or 2003.

Duration of Gross Unrealized Loss Positions for Cost Method Investments

The following table shows the fair value and gross unrealized losses aggregated by length of time that individual cost method investments have been in a continuous unrealized loss position, at December 31:

2004					
Less than twelve months		Twelve months or more		Total	
Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(in millions)					
Cost Method Investments	\$ 2	\$—	\$10	\$12	\$2
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
2003					
Less than twelve months		Twelve months or more		Total	
Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(in millions)					
Cost Method Investments	\$—	\$—	\$20	\$20	\$8
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

4. INVESTMENTS (continued)

The aggregate cost of the Company's cost method investments included in "Other long-term investments" totaled \$80 million at both December 31, 2004 and 2003. At December 31, 2004, gross unrealized losses on cost method investments were \$2 million, compared to \$8 million at December 31, 2003. In accordance with its policy described in Note 2, the Company concluded that an adjustment for other than temporary impairments for these securities was not warranted at December 31, 2004 or 2003.

Securities Pledged, Restricted Assets and Special Deposits

The Company pledges investment securities it owns to unaffiliated parties through certain transactions, including securities lending, securities sold under agreements to repurchase and futures contracts. At December 31, the carrying value of investments pledged to third parties as reported in the Consolidated Statements of Financial Position included the following:

	<u>2004</u>	<u>2003</u>
	(in millions)	
Fixed maturities, available for sale	\$16,037	\$13,537
Other trading account assets	340	1,927
Separate account assets	3,467	3,196
Total securities pledged	<u>\$19,844</u>	<u>\$18,660</u>

In the normal course of its business activities, the Company accepts collateral that can be sold or repledged. The primary sources of this collateral are securities in customer accounts, securities purchased under agreements to resell and securities borrowed transactions. The fair value of this collateral was approximately \$369 million and \$1,628 million at December 31, 2004 and 2003, respectively, of which \$369 million in 2004 and \$1,478 million in 2003 had either been sold or repledged.

Assets of \$528 million and \$419 million at December 31, 2004 and 2003, respectively, were on deposit with governmental authorities or trustees. Additionally, assets valued at \$706 million and \$601 million at December 31, 2004 and 2003, respectively, were held in voluntary trusts established primarily to fund guaranteed dividends to certain policyholders and to fund certain employee benefits. Assets valued at \$22 million and \$2 million at December 31, 2004 and 2003, respectively, were held as collateral. Letter stock or other securities restricted as to sale amounted to \$2 million and \$11 million at December 31, 2004 and 2003, respectively. Restricted cash and securities of \$2,512 million and \$1,908 million at December 31, 2004 and 2003, respectively, were included in "Other assets." The restricted cash and securities primarily represent funds deposited by clients and funds accruing to clients as a result of trades or contracts.

5. DEFERRED POLICY ACQUISITION COSTS

The balances of and changes in deferred policy acquisition costs as of and for the years ended December 31, are as follows:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
	(in millions)		
Balance, beginning of year	\$7,826	\$7,031	\$ 6,868
Capitalization of commissions, sales and issue expenses	1,537	1,584	1,478
Amortization	(873)	(978)	(1,267)
Change in unrealized investment gains and losses	82	103	(216)
Impact of adoption of SOP 03-1	2	—	—
Disposition of subsidiaries	(1)	(118)	—
Foreign currency translation and other	274	204	168
Balance, end of year	<u>\$8,847</u>	<u>\$7,826</u>	<u>\$ 7,031</u>

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

6. VALUATION OF BUSINESS ACQUIRED AND GOODWILL AND OTHER INTANGIBLES

Valuation of Business Acquired

The balance of and changes in VOBA as of and for the years ended December 31, are as follows:

	<u>2004</u>	<u>2003</u>
	<u>(in millions)</u>	
Balance, beginning of year	\$ 489	\$117
Acquisitions	713	440
Amortization(1)	(93)	(90)
Interest(2)	41	17
Foreign currency translation	5	5
Impact of adoption of SOP 03-1	(130)	—
Opening balance sheet adjustment	(14)	—
Balance, end of year	<u>\$1,011</u>	<u>\$489</u>

- (1) The average expected life of VOBA varies by product. The average expected lives were approximately 25, 10, 7 and 9 years from the date of acquisition for the VOBA related to the businesses acquired from CIGNA and the acquired American Skandia, Aoba Life and Gibraltar Life businesses, respectively.
- (2) The interest accrual rates vary by product. The interest rates were 6.32% to 7.76%, 5.90%, 1.35% to 1.50% and .5% to 1.88% for the VOBA related to the businesses acquired from CIGNA and the acquired American Skandia, Aoba Life and Gibraltar Life businesses, respectively.

Certain contracts issued by American Skandia include a market value adjustment (“MVA”) feature that requires the Company to pay to the contractholder upon surrender the accreted value of the fund as well as a market value adjustment based on the crediting rates on the contract surrendered compared to crediting rates on newly issued contracts or an indexed rate at time of surrender, as applicable. As of December 31, 2003, this liability was reflected at market value, which considers the effects of unrealized gains and losses in contract value resulting from changes in crediting rates. Upon the adoption of SOP 03-1 on January 1, 2004, the Company changed its accounting for American Skandia’s contracts containing MVA features as described previously under “New Accounting Pronouncements.” The Company’s net VOBA balance decreased \$130 million upon the adoption of SOP 03-1, primarily due to the change in the liability for the MVA feature associated with the American Skandia business, since the expected cash flows on this business in force at the time of acquisition that corresponded to obligations covered by SOP 03-1 were considered in establishing the initial VOBA.

The following table provides estimated future amortization, net of interest, for the periods indicated.

	<u>VOBA</u> <u>Amortization</u> <u>(in millions)</u>
2005	\$ 107
2006	83
2007	71
2008	60
2009	51
2010 and thereafter	639
Total	<u>\$1,011</u>

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

6. VALUATION OF BUSINESS ACQUIRED AND GOODWILL AND OTHER INTANGIBLES (continued)

Goodwill and Other Intangibles

The changes in the book value of goodwill by segment are as follows:

Year Ended December 31, 2004						
	Balance at January 1	Acquisitions	Impairment Charge	Disposal of Reporting Unit	Other(a)	Balance at December 31
	(in millions)					
Asset Management	\$142	\$ 119	\$ —	\$ —	\$ 18	\$279
Retirement	—	445	—	—	—	445
International Insurance	14	—	—	—	1	15
International Investments	113	—	—	—	7	120
Corporate and Other	166	—	(53)	(6)	10	117
Total	<u>\$435</u>	<u>\$ 564</u>	<u>\$ (53)</u>	<u>\$ (6)</u>	<u>\$ 36</u>	<u>\$976</u>

Year Ended December 31, 2003						
	Balance at January 1	Acquisitions	Impairment Charge	Disposal of Reporting Unit	Other(a)	Balance at December 31
	(in millions)					
Asset Management	\$135	\$ —	\$ —	\$ —	\$ 7	\$142
International Insurance	—	14	—	—	—	14
International Investments	120	—	—	—	(7)	113
Corporate and Other	162	4	—	—	—	166
Total	<u>\$417</u>	<u>\$ 18</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$435</u>

Year Ended December 31, 2002						
	Balance at January 1	Acquisitions	Impairment Charge	Disposal of Reporting Unit	Other	Balance at December 31
	(in millions)					
Asset Management	\$ 54	\$ 85	\$ —	\$ (4)	\$ —	\$135
International Investments	87	33	—	—	—	120
Corporate and Other	184	14	(36)	—	—	162
Total	<u>\$325</u>	<u>\$ 132</u>	<u>\$ (36)</u>	<u>\$ (4)</u>	<u>\$ —</u>	<u>\$417</u>

(a) Other represents foreign currency translation and purchase price adjustments.

The Company tests goodwill for impairment annually as of December 31 and more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. As a result of the December 31, 2004 annual impairment test, the Company determined that the goodwill related to its Dryden Wealth Management business, a business the Company has decided to exit or sell, which is included in Corporate and Other above, was impaired. Accordingly, the Company recorded an impairment charge of \$53 million representing the entire carrying amount of the business's goodwill. The December 31, 2003 annual impairment test resulted in no impairments. As a result of the December 31, 2002 annual impairment test, the Company determined that the goodwill related to its Property and Casualty Insurance business, included in Corporate and Other above, was impaired. Accordingly, the Company recorded an impairment charge of \$33 million representing the entire carrying amount of the business's goodwill.

At December 31, 2004, the gross carrying amount and accumulated amortization for the Company's other intangibles subject to amortization amounted to \$384 million and \$168 million, respectively, and at December 31, 2003, \$336 million and \$133 million, respectively. Other intangibles not subject to amortization amounted to \$18 million and \$11 million at December 31, 2004 and 2003, respectively. Other intangibles consist primarily of mortgage servicing rights and customer relationships related to the Asset Management segment. At December 31, 2004 and 2003, mortgage servicing rights,

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

6. VALUATION OF BUSINESS ACQUIRED AND GOODWILL AND OTHER INTANGIBLES (continued)

including both purchased and originated servicing rights, were \$135 million (fair value of \$149 million) and \$122 million (fair value of \$129 million), respectively, and customer relationships were \$64 million and \$77 million, respectively. Amortization expense for other intangibles was \$34 million, \$35 million and \$27 million for the years ended December 31, 2004, 2003 and 2002, respectively. Amortization expense for other intangibles currently owned by the Company is expected to be approximately \$33 million for each of the next four years and \$23 million in the fifth year.

7. POLICYHOLDERS' LIABILITIES

Future Policy Benefits

Future policy benefits at December 31, are as follows:

	<u>2004</u>	<u>2003</u>
	(in millions)	
Life insurance	\$ 84,744	\$78,927
Individual and group annuities	17,066	15,504
Other contract liabilities	495	414
Total future policy benefits	<u>\$102,305</u>	<u>\$94,845</u>

Life insurance liabilities include reserves for death and endowment policy benefits, terminal dividends and certain health benefits. Individual and group annuities liabilities include reserves for life contingent immediate annuities and life contingent group annuities. Other contract liabilities primarily consist of unearned premium and benefit reserves for group and individual health products.

Future policy benefits for individual participating traditional life insurance are based on the net level premium method, calculated using the guaranteed mortality and nonforfeiture interest rates which range from 2.5% to 8.5%; less than 1% of the reserves are based on an interest rate in excess of 8%. Participating insurance represented 26% and 30% of domestic individual life insurance in force at December 31, 2004 and 2003, respectively, and 91%, 92% and 91% of domestic individual life insurance premiums for 2004, 2003 and 2002, respectively.

Future policy benefits for individual non-participating traditional life insurance policies, group and individual long-term care policies and individual health insurance policies are equal to the aggregate of (1) the present value of future benefit payments and related expenses, less the present value of future net premiums, and (2) premium deficiency reserves. Assumptions as to mortality, morbidity and persistency are based on the Company's experience when the basis of the reserve is established. Interest rates used for the aggregate reserves range from 0% to 11.3%; less than 2% of the reserves are based on an interest rate in excess of 8%.

Future policy benefits for individual and group annuities are equal to the aggregate of (1) the present value of expected future payments on the basis of actuarial assumptions established at issue, and (2) premium deficiency reserves. Assumptions as to mortality are based on the Company's experience when the basis of the reserve is established. The interest rates used in the determination of the aggregate reserves range from 1.4% to 14.8%; less than 2% of the reserves are based on an interest rate in excess of 8%.

Future policy benefits for other contract liabilities are generally equal to the present value of expected future payments based on the Company's experience (except for certain group insurance coverages for which future policy benefits are equal to gross unearned premium reserves). The interest rates used in the determination of the aggregate reserves range from 0% to 8.8%; less than 1% of the reserves are based on an interest rate in excess of 8%.

Premium deficiency reserves are established, if necessary, when the liability for future policy benefits plus the present value of expected future gross premiums are determined to be insufficient to provide for expected future policy benefits and expenses and to recover any unamortized policy acquisition costs. Premium deficiency reserves have been recorded for the

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

7. POLICYHOLDERS' LIABILITIES *(continued)*

group single premium annuity business, which consists of limited-payment, long-duration traditional and non-participating annuities; structured settlements and single premium immediate annuities with life contingencies; and for certain individual health policies. Liabilities of \$3,300 million and \$2,830 million are included in "Future policy benefits" with respect to these deficiencies at December 31, 2004 and 2003, respectively.

The Company's liability for future policy benefits is also inclusive of liabilities for guarantee benefits related to certain nontraditional long-duration life and annuity contracts, which are discussed more fully in Note 8.

Policyholders' Account Balances

Policyholders' account balances at December 31, are as follows:

	2004	2003
	(in millions)	
Individual annuities	\$14,297	\$ 9,565
Group annuities(1)	20,694	4,046
Guaranteed investment contracts and guaranteed interest accounts(1)	14,223	13,951
Funding agreements	3,147	1,451
Interest-sensitive life contracts	9,282	8,400
Dividend accumulations and other	13,582	12,278
Policyholders' account balances	<u>\$75,225</u>	<u>\$49,691</u>

- (1) Includes as of December 31, 2004, \$16,356 million of group annuities and \$825 million of guaranteed investment contracts associated with the retirement business acquired from CIGNA. The interest crediting rates for these contracts range from 3% to 7.4% for group annuities and 5.4% to 9.1% for guaranteed investment contracts.

Policyholders' account balances represent an accumulation of account deposits plus credited interest less withdrawals, expenses and mortality charges, if applicable. These policyholders' account balances also include provisions for benefits under non-life contingent payout annuities. Included in "Funding agreements" at December 31, 2004 and 2003, are \$2,756 and \$1,052 million, respectively, of medium-term notes of consolidated variable interest entities secured by funding agreements purchased from the Company with the proceeds of such notes. The interest rates associated with such notes range from 1.3% to 4.4%. Interest crediting rates range from 0.5% to 8% for interest-sensitive life contracts and from 0% to 14% for contracts other than interest-sensitive life. Less than 2% of policyholders' account balances have interest crediting rates in excess of 8%.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

7. POLICYHOLDERS' LIABILITIES *(continued)*

Unpaid Claims and Claim Adjustment Expenses

The following table provides a reconciliation of the activity in the liability for unpaid claims and claim adjustment expenses for accident and health insurance and property and casualty insurance at December 31:

	2004		2003		2002	
	Accident and Health	Property and Casualty	Accident and Health	Property and Casualty	Accident and Health	Property and Casualty
	(in millions)					
Balance at January 1	\$1,629	\$ 58	\$1,567	\$ 1,861	\$1,655	\$1,753
Less reinsurance recoverables, net	17	—	24	598	129	671
Net balance at January 1	1,612	58	1,543	1,263	1,526	1,082
Incurred related to:						
Current year	675	7	634	1,184	627	1,615
Prior years	48	3	33	(22)	(32)	(15)
Total incurred	723	10	667	1,162	595	1,600
Paid related to:						
Current year	248	7	237	706	237	967
Prior years	364	—	361	297	341	452
Total paid	612	7	598	1,003	578	1,419
Acquisitions (dispositions) and other	8	(3)	—	(1,364)	—	—
Net balance at December 31	1,731	58	1,612	58	1,543	1,263
Plus reinsurance recoverables, net	18	—	17	—	24	598
Balance at December 31	\$1,749	\$ 58	\$1,629	\$ 58	\$1,567	\$1,861

The unpaid claims and claim adjustment expenses presented above include estimates for liabilities associated with reported claims and for incurred but not reported claims based, in part, on the Company's experience. Changes in the estimated cost to settle unpaid claims are charged or credited to the Consolidated Statements of Operations periodically as the estimates are revised. Accident and health unpaid claims liabilities are discounted using interest rates ranging from 0.0% to 6.4%.

The property and casualty reinsurance recoverable balance related to unpaid claims at December 31, 2004, 2003 and 2002 includes \$0 million, \$0 million and \$151 million, respectively, attributable to the Company's discontinued property and casualty businesses. The accident and health reinsurance recoverable balance related to unpaid claims at December 31, 2004, 2003 and 2002 includes \$0 million, \$1 million and \$9 million, respectively, attributable to the Company's discontinued healthcare business.

The amounts incurred for claims and claim adjustment expenses for accident and health in 2004 and 2003 that related to prior years were primarily due to required interest somewhat offset by long-term disability claim termination experience. The amounts incurred for claims and claim adjustment expenses for accident and health in 2002 that related to prior years was due to long-term disability claim termination experience. The amounts incurred for claims and claim adjustment expenses for property and casualty in 2003 and 2002 that related to prior years were primarily driven by lower than anticipated losses for the auto line of business and prior period reserve releases.

8. CERTAIN NONTRADITIONAL LONG-DURATION CONTRACTS

The Company issues traditional variable annuity contracts through its separate accounts for which investment income and investment gains and losses accrue directly to, and investment risk is borne by, the contractholder. The Company also issues variable annuity contracts with general and separate account options where the Company contractually guarantees to the contractholder a return of no less than (a) total deposits made to the contract less any partial withdrawals ("return of net

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

8. CERTAIN NONTRADITIONAL LONG-DURATION CONTRACTS (continued)

deposits”), (b) total deposits made to the contract less any partial withdrawals plus a minimum return (“minimum return”), or (c) the highest contract value on a specified anniversary date minus any withdrawals following the contract anniversary (“anniversary contract value”). These guarantees include benefits that are payable in the event of death, annuitization or at specified dates during the accumulation period.

The Company also issues annuity contracts with market value adjusted investment options (“MVAs”), which provide for a return of principal plus a fixed rate of return if held to maturity, or, alternatively, a “market adjusted value” if surrendered prior to maturity. The market value adjustment may result in a gain or loss to the Company, depending on crediting rates or an indexed rate at surrender, as applicable.

In addition, the Company issues variable life, variable universal life and universal life contracts where the Company contractually guarantees to the contractholder a death benefit even when there is insufficient value to cover monthly mortality and expense charges, whereas otherwise the contract would typically lapse (“no lapse guarantee”). Variable life and variable universal life contracts are offered with general and separate account options.

The assets supporting the variable portion of both traditional variable annuities and certain variable contracts with guarantees are carried at fair value and reported as “Separate account assets” with an equivalent amount reported as “Separate account liabilities.” Amounts assessed against the contractholders for mortality, administration, and other services are included within revenue in “Policy charges and fee income” and changes in liabilities for minimum guarantees are generally included in “Policyholders’ benefits.” In 2004 there were no gains or losses on transfers of assets from the general account to a separate account.

For those guarantees of benefits that are payable in the event of death, the net amount at risk is generally defined as the current guaranteed minimum death benefit in excess of the current account balance at the balance sheet date. For guarantees of benefits that are payable at annuitization, the net amount at risk is generally defined as the present value of the minimum guaranteed annuity payments available to the contractholder determined in accordance with the terms of the contract in excess of the current account balance. For guarantees of accumulation balances, the net amount at risk is generally defined as the guaranteed minimum accumulation balance minus the current account balance. The Company’s contracts with guarantees may offer more than one type of guarantee in each contract; therefore, the amounts listed may not be mutually exclusive. As of December 31, 2004, the Company had the following guarantees associated with these contracts, by product and guarantee type:

	December 31, 2004	
	<u>In the Event of Death</u>	<u>At Annuitization / Accumulation</u>
	(dollars in millions)	
Variable Annuity Contracts		
<i>Return of net deposits</i>		
Account value	\$ 30,097	N/A
Net amount at risk	\$ 2,789	N/A
Average attained age of contractholders	62 years	N/A
<i>Minimum return or anniversary contract value</i>		
Account value	\$ 15,816	\$ 8,672
Net amount at risk	\$ 1,649	\$ 3
Average attained age of contractholders	65 years	59 years
Average period remaining until earliest expected annuitization	N/A	6 years
	<u>Unadjusted Value</u>	<u>Adjusted Value</u>
<i>Market value adjusted annuities</i>		
Account value	\$ 1,680	\$ 1,753

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

8. CERTAIN NONTRADITIONAL LONG-DURATION CONTRACTS *(continued)*

	<u>December 31, 2004</u> <u>In the Event of Death</u> (dollars in millions)
Variable Life, Variable Universal Life and Universal Life Contracts	
<i>No lapse guarantees</i>	
Separate account value	\$ 1,651
General account value	\$ 2,292
Net amount at risk	\$ 59,923
Average attained age of contractholders	39 years

Account balances of variable annuity contracts with guarantees were invested in separate account investment options as follows:

	<u>December 31, 2004</u> (in millions)
Equity funds	\$27,714
Bond funds	6,173
Balanced funds	2,737
Money market funds	1,777
Other	2,266
Total	<u>\$40,667</u>

In addition to the amounts invested in separate account investment options above, \$5,246 million of account balances of variable annuity contracts with guarantees, inclusive of contracts with MVA features, were invested in general account investment options.

Liabilities For Guarantee Benefits

The table below summarizes the changes in general account liabilities for guarantees on variable contracts. The liabilities for guaranteed minimum death benefits (“GMDB”) and guaranteed minimum income benefits (“GMIB”) are included in “Future policy benefits” and the related changes in the liabilities are included in “Policyholders’ benefits.” Guaranteed minimum withdrawal benefits (“GMWB”) and guaranteed return option (“GRO”) features are considered to be derivatives under SFAS No. 133, and changes in the fair value of the derivative are recognized through “Realized investment gains (losses), net.” At December 31, 2004, there were no liabilities recorded related to these derivatives.

	<u>Guaranteed Minimum Death Benefit (GMDB)</u>	<u>Guaranteed Minimum Income Benefit (GMIB)</u>	<u>Guaranteed Return Option/Minimum Withdrawal Benefit (GRO / GMWB)</u>	<u>Total</u>
	(in millions)			
Balance at January 1, 2004	\$ 70	\$ 2	\$ —	\$ 72
Incurred guarantee benefits	86	6	—	92
Paid guarantee benefits	(68)	—	—	(68)
Balance at December 31, 2004	<u>\$ 88</u>	<u>\$ 8</u>	<u>\$ —</u>	<u>\$ 96</u>

The GMDB liability is determined each period end by estimating the accumulated value of a percentage of the total assessments to date less the accumulated value of the death benefits in excess of the account balance. The percentage of assessments used is chosen such that, at issue (or, in the case of American Skandia contracts, at the acquisition date), the present value of expected death benefits in excess of the projected account balance and the percentage of the present value of total expected assessments over the lifetime of the contracts are equal. The Company regularly evaluates the estimates used and adjusts the GMDB liability balance, with a related charge or credit to earnings, if actual experience or other evidence

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

8. CERTAIN NONTRADITIONAL LONG-DURATION CONTRACTS (continued)

suggests that earlier assumptions should be revised. The GMIB liability was determined at December 31, 2004 by estimating the accumulated value of a percentage of the total assessments to date less the accumulated value of the projected income benefits in excess of the account balance.

The present value of death benefits in excess of the projected account balance and the present value of total expected assessments for GMDB's were determined over a reasonable range of stochastically generated scenarios. For variable annuities and variable universal life, 5,000 scenarios were stochastically generated and, from these, 200 scenarios were selected using a sampling technique. For variable life, various scenarios covering a reasonable range were weighted based on a statistical lognormal model. For universal life, 10,000 scenarios were stochastically generated and, from these, 100 were selected.

The GRO features predominantly provide for a guaranteed return of initial account value over a contractually defined period equal to seven years. One other variation of the GRO feature has an additional optional benefit that will provide for a base guarantee of account value seven years after the benefit is effective and every anniversary date thereafter and, if elected, an enhanced guarantee equal to the account value seven years after the effective date of any "step-up" and every anniversary date thereafter. All guaranteed amounts include any additional purchase payments and credits less withdrawals. Significant or prolonged declines in the value of any variable investment options a customer may choose as part of their GRO benefit may result in all or a substantial portion of their account values being allocated to fixed investment allocations, in conjunction with the Company's automatic rebalancing program associated with this feature.

The GMWB features provide the contractholder with a guaranteed remaining balance if the account value is reduced to zero through a combination of market declines and withdrawals. The guaranteed remaining balance is generally equal to the protected value under the contract, which is initially established as the greater of the account value or cumulative premiums when withdrawals commence, less cumulative withdrawals. The contractholder also has the option, after a specified time period, to reset the guaranteed remaining balance to the then-current account value, if greater.

Sales Inducements

The Company defers sales inducements and amortizes them over the anticipated life of the policy using the same methodology and assumptions used to amortize deferred policy acquisition costs. These deferred sales inducements are included in "Other assets." The Company offers various types of sales inducements. These inducements include: (i) a bonus whereby the policyholder's initial account balance is increased by an amount equal to a specified percentage of the customer's initial deposit and (ii) additional interest credits after a certain number of years a contract is held. Changes in deferred sales inducements are as follows:

	Sales Inducements (in millions)
Balance at January 1, 2004	\$156
Capitalization	132
Amortization	(24)
Balance at December 31, 2004	<u>\$264</u>

9. 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. For a discussion of the Closed Block Business see Note 20. The Company established a separate closed block for participating individual life insurance policies issued by the Canadian branch of Prudential Insurance. Due to the substantially smaller number of outstanding Canadian policies, this separate closed block is insignificant in size and is not included in the information presented below.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

9. CLOSED BLOCK (continued)

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. As of December 31, 2004, the Company has not recognized a policyholder dividend obligation for the excess of actual cumulative earnings over the expected cumulative earnings. However, net unrealized investment gains that have arisen subsequent to the establishment of the Closed Block have been reflected as policyholder dividend obligations of \$3,141 million and \$2,443 million at December 31, 2004 and 2003, respectively, to be paid to Closed Block policyholders unless otherwise offset by future experience, with an offsetting amount reported in "Accumulated other comprehensive income (loss)."

On December 14, 2004, Prudential Insurance's Board of Directors acted to reduce dividends, effective January 1, 2005 on Closed Block policies to reflect changes in the economic environment, primarily the persistent low levels of fixed income interest rates experienced in recent years, as well as poor equity returns. These actions resulted in a \$91 million reduction of the liability for policyholder dividends recognized in the year ended December 31, 2004.

Closed Block Liabilities and Assets designated to the Closed Block at December 31, as well as maximum future earnings to be recognized from Closed Block Liabilities and Closed Block Assets, are as follows:

	<u>2004</u>	<u>2003</u>
	(in millions)	
Closed Block Liabilities		
Future policy benefits	\$49,511	\$48,842
Policyholders' dividends payable	1,077	1,168
Policyholder dividend obligation	3,141	2,443
Policyholders' account balances	5,557	5,523
Other Closed Block liabilities	8,943	7,222
Total Closed Block Liabilities	<u>68,229</u>	<u>65,198</u>

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

9. CLOSED BLOCK (continued)

	2004	2003
	(in millions)	
Closed Block Assets		
Fixed maturities, available for sale, at fair value	44,870	40,517
Equity securities, available for sale, at fair value	2,620	2,282
Commercial loans	6,707	6,423
Policy loans	5,454	5,543
Other long-term investments	996	983
Short-term investments	1,769	3,361
Total investments	62,416	59,109
Cash and cash equivalents	1,800	2,075
Accrued investment income	668	693
Other Closed Block assets	343	323
Total Closed Block Assets	65,227	62,200
Excess of reported Closed Block Liabilities over Closed Block Assets	3,002	2,998
Portion of above representing accumulated other comprehensive income:		
Net unrealized investment gains	3,459	3,415
Allocated to policyholder dividend obligation	(3,141)	(2,443)
Future earnings to be recognized from Closed Block Assets and Closed Block Liabilities	\$ 3,320	\$ 3,970

Information regarding the policyholder dividend obligation is as follows:

	2004	2003
	(in millions)	
Balance, January 1	\$2,443	\$1,606
Impact on income before gains allocable to policyholder dividend obligation	—	—
Net investment gains	—	—
Unrealized investment gains	698	837
Balance, December 31	\$3,141	\$2,443

Closed Block revenues and benefits and expenses for the years ended December 31, 2004, 2003 and 2002 were as follows:

	2004	2003	2002
	(in millions)		
Revenues			
Premiums	\$3,776	\$3,860	\$4,022
Net investment income	3,392	3,326	3,333
Realized investment gains (losses), net	709	430	(521)
Other income	59	64	68
Total Closed Block revenues	7,936	7,680	6,902
Benefits and Expenses			
Policyholders' benefits	4,056	4,174	4,310
Interest credited to policyholders' account balances	137	139	139
Dividends to policyholders	2,364	2,452	2,506
General and administrative expenses	710	759	801
Total Closed Block benefits and expenses	7,267	7,524	7,756
Closed Block revenues, net of Closed Block benefits and expenses, before income taxes	669	156	(854)
Income tax expense (benefit)	19	(21)	(147)
Closed Block revenues, net of Closed Block benefits and expenses and income taxes	\$ 650	\$ 177	\$ (707)

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

10. REINSURANCE

The Company participates in reinsurance in order to provide additional capacity for future growth and limit the maximum net loss potential arising from large risks. In addition, the acquisition of the retirement business of CIGNA on April 1, 2004, required the Company through its wholly owned subsidiary, PRIAC, to enter into certain reinsurance arrangements with CIGNA to effect the transfer of the retirement business included in the transaction. These reinsurance arrangements include coinsurance-with-assumption, modified-coinsurance-with-assumption, and modified-coinsurance-without-assumption and are more fully described in Note 3.

Life reinsurance is accomplished through various plans of reinsurance, primarily yearly renewable term and coinsurance. Prior to the sale of the Company's property and casualty insurance businesses, property and casualty reinsurance was placed on a pro-rata basis and excess of loss, including stop-loss, basis. Reinsurance ceded arrangements do not discharge the Company as the primary insurer. Ceded balances would represent a liability of the Company in the event the reinsurers were unable to meet their obligations to the Company under the terms of the reinsurance agreements. Reinsurance premiums, commissions, expense reimbursements, benefits and reserves related to reinsured long-duration contracts are accounted for over the life of the underlying reinsured contracts using assumptions consistent with those used to account for the underlying contracts. The cost of reinsurance related to short-duration contracts is accounted for over the reinsurance contract period. Amounts recoverable from reinsurers, for both short-and long-duration reinsurance arrangements, are estimated in a manner consistent with the claim liabilities and policy benefits associated with the reinsured policies.

The tables presented below exclude amounts pertaining to the Company's discontinued operations.

Reinsurance amounts included in the Consolidated Statements of Operations for the years ended December 31, were as follows:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
		(in millions)	
Direct premiums	\$13,366	\$13,968	\$13,731
Reinsurance assumed(1)	103	133	103
Reinsurance ceded	(889)	(868)	(781)
Premiums	<u>\$12,580</u>	<u>\$13,233</u>	<u>\$13,053</u>
Policyholders' benefits ceded	<u>\$ 908</u>	<u>\$ 840</u>	<u>\$ 798</u>

- (1) Includes \$2 million of premiums assumed for the period April 1, 2004 through December 31, 2004 under the reinsurance arrangements associated with acquisition of the retirement business of CIGNA.

Reinsurance recoverables at December 31, are as follows:

	<u>2004</u>	<u>2003</u>
	(in millions)	
Individual and group annuities(1)	\$32,215	\$ —
Life insurance	507	521
Other reinsurance	61	66
Total reinsurance recoverable	<u>\$32,783</u>	<u>\$ 587</u>

- (1) Represents reinsurance recoverables as of December 31, 2004, under the modified coinsurance arrangement associated with the acquisition of the retirement business of CIGNA. At December 31, 2004, the Company has recorded a related reinsurance payable of \$32,198 million.

Excluding the reinsurance recoverable associated with the acquisition of the retirement business of CIGNA, three major reinsurance companies account for approximately 67% of the reinsurance recoverable at December 31, 2004. The Company periodically reviews the financial condition of its reinsurers and amounts recoverable therefrom in order to minimize its exposure to loss from reinsurer insolvencies, recording an allowance when necessary for uncollectible reinsurance.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

11. SHORT-TERM AND LONG-TERM DEBT

Short-term Debt

Short-term debt at December 31, is as follows:

	<u>2004</u>	<u>2003</u>
	<u>(in millions)</u>	
Commercial paper	\$2,447	\$3,258
Notes payable	1,539	1,027
Current portion of long-term debt	58	454
Total short-term debt	<u>\$4,044</u>	<u>\$4,739</u>

The weighted average interest rate on outstanding short-term debt, excluding the current portion of long-term debt, was approximately 2.2% and 1.1% at December 31, 2004 and 2003, respectively.

At December 31, 2004, the Company had \$3,338 million in committed lines of credit from numerous financial institutions, of which \$3,326 million were unused. These lines of credit generally have terms ranging from one to five years.

The Company issues commercial paper primarily to manage operating cash flows and existing commitments, to meet working capital needs and to take advantage of current investment opportunities. At December 31, 2004 and 2003, a portion of commercial paper borrowings were supported by \$2,500 million of the Company's existing lines of credit. At December 31, 2004 and 2003, the weighted average maturity of commercial paper outstanding was 23 and 18 days, respectively.

Long-term Debt

Long-term debt at December 31, is as follows:

<u>Description</u>	<u>Maturity Dates</u>	<u>Rate</u>	<u>2004</u>	<u>2003</u>
			<u>(in millions)</u>	
Prudential Holdings, LLC notes (the "IHC debt")				
Series A	2017(a)	(c)	\$ 333	\$ 333
Series B	2023(a)	7.245%	777	777
Series C	2023(a)	8.695%	640	640
Fixed rate notes				
Fixed rate note subject to set-off arrangements	2009	4.45%	952	—
Other fixed rate notes	2006-2033(b)	3.00%-7.30%	4,977	3,169
Floating rate notes ("FRNs")	2011-2014	(d)	40	—
Surplus notes	2007-2025	(e)	692	691
Sub-total			<u>8,411</u>	<u>5,610</u>
Less assets under set-off arrangements(f)			<u>784</u>	<u>—</u>
Total long-term debt			<u>\$7,627</u>	<u>\$5,610</u>

- (a) Annual scheduled repayments of principal for the Series A and Series C notes begin in 2013. Annual scheduled repayments of principal for the Series B notes begin in 2018.
- (b) U.S. dollar fixed rate notes at December 31, 2003 include \$711 million related to the issuance of equity security units. See Note 12 for more details regarding equity security units.
- (c) The interest rate on the Series A notes is a floating rate equal to LIBOR plus 0.875% per year. The interest rate ranged from 2.0% to 3.4% in 2004 and 1.94% to 2.29% in 2003.
- (d) The interest rates on the U.S. dollar denominated FRNs are based on the U.S. Consumer Price Index. Interest rates ranged from 4.04% to 5.09% in 2004.
- (e) The interest rate on the Surplus notes ranged from 7.65% to 8.30% in 2004 and 2003.
- (f) Assets under set-off arrangements represent a reduction in the amount of fixed rate notes included in long-term debt, relating to an arrangement where valid rights of set-off exist and it is the intent of both parties to settle on a net basis under legally enforceable arrangements.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

11. SHORT-TERM AND LONG-TERM DEBT *(continued)*

Several long-term debt agreements have restrictive covenants related to the total amount of debt, net tangible assets and other matters. At December 31, 2004 and 2003, the Company was in compliance with all debt covenants.

Payment of interest and principal on the surplus notes issued after 1993, of which \$692 million and \$691 million was outstanding at December 31, 2004 and 2003, respectively, may be made only with the prior approval of the Commissioner of Banking and Insurance of the State of New Jersey (the "Commissioner"). The Commissioner could prohibit the payment of the interest and principal on the surplus notes if certain statutory capital requirements are not met. At December 31, 2004, the Company has met these statutory capital requirements.

In order to modify exposure to interest rate and currency exchange rate movements, the Company utilizes derivative instruments, primarily interest rate swaps, in conjunction with some of its debt issues. These instruments qualify for hedge accounting treatment. The impact of these instruments, which is not reflected in the rates presented in the table above, were decreases in interest expense of \$40 million and \$18 million for the years ended December 31, 2004 and 2003, respectively. Floating rates are determined by contractual formulas and may be subject to certain minimum or maximum rates. See Note 19 for additional information on the Company's use of derivative instruments.

Interest expense for short-term and long-term debt was \$492 million, \$403 million and \$427 million, for the years ended December 31, 2004, 2003 and 2002, respectively. Securities business related interest expense of \$72 million, \$82 million and \$144 million for the years ended December 31, 2004, 2003 and 2002, respectively, is included in "Net investment income."

Included in "Policyholders' account balances" are additional debt obligations of the Company. See Note 7 for further discussion.

Prudential Holdings, LLC Notes

On the date of demutualization, Prudential Holdings, LLC ("PHLLC"), a wholly owned subsidiary of Prudential Financial, issued \$1.75 billion in senior secured notes (the "IHC debt"). PHLLC owns the capital stock of Prudential Insurance and does not have any operating businesses of its own. The IHC debt represents senior secured obligations of PHLLC with limited recourse; neither Prudential Financial, Prudential Insurance nor any other affiliate of PHLLC is an obligor or guarantor on the IHC debt. The IHC debt is collateralized by 13.8% of the outstanding common stock of Prudential Insurance and other items specified in the indenture, primarily the "Debt Service Coverage Account" (the "DSCA") discussed below.

PHLLC's ability to meet its obligations under the IHC debt is dependent principally upon sufficient available funds being generated by the Closed Block Business and the ability of Prudential Insurance, the sole direct subsidiary of PHLLC, to dividend such funds to PHLLC. The payment of scheduled principal and interest on the Series A notes and the Series B notes is insured by a financial guarantee insurance policy. The payment of principal and interest on the Series C notes is not insured. The IHC debt is redeemable prior to its stated maturity at the option of PHLLC and, in the event of certain circumstances, the IHC debt bond insurer can require PHLLC to redeem the IHC debt.

Net proceeds from the IHC debt amounted to \$1,727 million. The majority of the net proceeds, or \$1,218 million, was distributed to Prudential Financial through a dividend on the date of demutualization for use in the Financial Services Businesses. Net proceeds of \$437 million were deposited to a restricted account within PHLLC. This restricted account, referred to as the DSCA, constitutes additional collateral for the IHC debt. The remainder of the net proceeds, or \$72 million, was used to purchase a guaranteed investment contract to fund a portion of the financial guarantee insurance premium related to the IHC debt.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

11. SHORT-TERM AND LONG-TERM DEBT (continued)

Summarized consolidated financial data for Prudential Holdings, LLC is presented below.

	<u>2004</u>	<u>2003</u>	
	(in millions)		
<u>Consolidated Statements of Financial Position data at December 31:</u>			
Total assets	\$305,471	\$237,242	
Total liabilities	288,188	220,710	
Total equity	17,283	16,532	
Total liabilities and equity	305,471	237,242	
	<u>2004</u>	<u>2003</u>	<u>2002</u>
	(in millions)		
<u>Consolidated Statements of Operations data for the years ended December 31:</u>			
Total revenues	\$ 18,982	\$ 17,344	\$15,906
Total benefits and expenses	16,390	15,891	16,050
Income (loss) from continuing operations before income taxes and cumulative effect of accounting change	2,592	1,453	(144)
Net income (loss)	1,800	1,085	(93)
<u>Consolidated Statements of Cash Flows data for the years ended December 31:</u>			
Cash flows from operating activities	\$ 3,885	\$ 1,122	\$ 4,206
Cash flows used in investing activities	(6,341)	(2,097)	(7,503)
Cash flows from financing activities	2,134	483	2,654
Effect of foreign exchange rate changes on cash balances	(32)	8	4
Net decrease in cash and cash equivalents	(354)	(484)	(639)

Prudential Financial is a holding company and is a legal entity separate and distinct from its subsidiaries. The rights of Prudential Financial to participate in any distribution of assets of any subsidiary, including upon its liquidation or reorganization, are subject to the prior claims of creditors of that subsidiary, except to the extent that Prudential Financial may itself be a creditor of that subsidiary and its claims are recognized. PHLLC and its subsidiaries have entered into covenants and arrangements with third parties in connection with the issuance of the IHC debt which are intended to confirm their separate, “bankruptcy-remote” status, by assuring that the assets of PHLLC and its subsidiaries are not available to creditors of Prudential Financial or its other subsidiaries, except and to the extent that Prudential Financial and its other subsidiaries are, as shareholders or creditors of PHLLC and its subsidiaries, or would be, entitled to those assets.

At December 31, 2004, the Company was in compliance with all IHC debt covenants.

12. EQUITY SECURITY UNITS

In December 2001, in connection with the demutualization, Prudential Financial and Prudential Financial Capital Trust I (the “Trust”) co-issued 13,800,000 6.75% equity security units (the “Units”) to the public at an offering price of \$50 per Unit for gross proceeds of \$690 million. Each Unit had a stated amount of \$50 and initially consisted of (1) a contract requiring the holder to purchase, for \$50, shares of Common Stock of Prudential Financial by November 15, 2004 (the “purchase contract”), at a price determined by a formula described in the purchase contract and (2) a redeemable capital security of the Trust, with a stated liquidation amount of \$50.

In accordance with the terms of the Units, the Trust was dissolved on July 29, 2004, and \$690 million aggregate principal amount of 5.34% debentures of Prudential Financial maturing on November 15, 2006 (the “Debentures”), the sole assets of the Trust, were distributed to the owners of the Trust’s capital securities in exchange for their capital securities. The Debentures were remarketed on behalf of the debenture owners on August 6, 2004 and the interest rate on the Debentures was reset as of August 11, 2004 to 4.104% per annum.

In November 2004, the Company settled the purchase contracts associated with the Units by issuing 20.3 million new shares of Common Stock (based on 1.47 shares of Common Stock per purchase contract) for proceeds of \$690 million.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

12. EQUITY SECURITY UNITS *(continued)*

At the time of issuance of the Units, the Trust also issued 426,805 shares of common securities to Prudential Financial at a price of \$50 per common security for gross proceeds of \$21 million. The combined proceeds to the Trust from the issuances of the redeemable capital securities and the common securities were invested by the Trust in \$711 million of the 5.34% Debentures. As of December 31, 2003, the \$711 million of 5.34% Debentures are reported as "Long-term debt," and the investment in common securities of \$21 million is reported in "Other long-term investments." As of December 31, 2004 the \$690 million of 4.104% Debentures are reported as "Long-term debt."

13. STOCKHOLDERS' EQUITY

Preferred Stock

Prudential Financial adopted a shareholder rights plan (the "rights plan") under which each outstanding share of Common Stock is coupled with a shareholder right. The rights plan is not applicable to any Class B Stock. Each right initially entitles the holder to purchase one one-thousandth of a share of a series of Prudential Financial preferred stock upon payment of the exercise price. At the time of the demutualization, the Board of Directors of Prudential Financial determined that the initial exercise price per right is \$110, subject to adjustment from time to time as provided in the rights plan. There was no preferred stock outstanding at December 31, 2004 and 2003.

Common Stock and Class B Stock

On the date of demutualization, Prudential Financial completed an initial public offering of 110.0 million shares of its Common Stock at an initial public offering price of \$27.50 per share. The shares of Common Stock issued in the offerings were in addition to shares of Common Stock the Company distributed to policyholders as part of the demutualization. On December 21, 2001, Prudential Financial issued an additional 16.5 million shares of Common Stock at an offering price of \$27.50 per share as a result of the exercise of the over-allotment option granted to underwriters in the initial public offering. The Common Stock is traded on the New York Stock Exchange under the symbol "PRU." Also on the date of demutualization, Prudential Financial completed the sale, through a private placement, of 2.0 million shares of Class B Stock at a price of \$87.50 per share. The Class B Stock is a separate class of common stock which is not publicly traded. The Common Stock reflects the performance of the Financial Services Businesses and the Class B Stock reflects the performance of the Closed Block Business.

Holders of Common Stock have no interest in a separate legal entity representing the Financial Services Businesses and 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.

Dividends

The principal sources of funds available to Prudential Financial, the parent holding company, to meet its obligations, including the payment of shareholder dividends, debt service, capital contributions and obligations to subsidiaries, and operating expenses, are cash and short-term investments, dividends, returns of capital, and interest income from its subsidiaries. The regulated insurance and various other subsidiaries are subject to regulatory limitations on their payment of dividends and other transfers of funds to Prudential Financial. Pursuant to Gibraltar Life's reorganization, in addition to regulatory restrictions, there are certain restrictions that preclude Gibraltar Life from paying dividends to Prudential Financial in the near term.

New Jersey insurance law provides that dividends or distributions may be declared or paid by Prudential Insurance without prior regulatory approval only from unassigned surplus, as determined pursuant to statutory accounting principles, less unrealized capital gains and certain other adjustments. Unassigned surplus of Prudential Insurance was \$3,327 million at

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

13. STOCKHOLDERS' EQUITY *(continued)*

December 31, 2004. There were applicable adjustments for unrealized gains of \$824 million at December 31, 2004. In addition, Prudential Insurance must obtain non-disapproval from the New Jersey insurance regulator before paying a dividend if the dividend, together with other dividends or distributions made within the preceding twelve months, would exceed the greater of 10% of Prudential Insurance's surplus as of the preceding December 31 (\$8.4 billion as of December 31, 2004) or its net gain from operations for the twelve month period ending on the preceding December 31, excluding realized capital gains and losses (\$1.5 billion for the year ended December 31, 2004).

The laws regulating dividends of Prudential Financial's other insurance subsidiaries domiciled in other states are similar, but not identical, to New Jersey's. The laws of foreign countries may also limit the ability of the Company's insurance and other subsidiaries organized in those countries to pay dividends to Prudential Financial.

The declaration and payment of dividends on the Common Stock depends primarily upon the financial condition, results of operations, cash requirements, future prospects and other factors relating to the Financial Services Businesses. Furthermore, dividends on the Common Stock are limited to both the amount that is legally available for payment under New Jersey corporate law if the Financial Services Businesses were treated as a separate corporation thereunder and the amount that is legally available for payment under New Jersey corporate law on a consolidated basis after taking into account dividends on the Class B Stock.

The declaration and payment of dividends on the Class B Stock depends upon the financial performance of the Closed Block Business and, as the Closed Block matures, the holders of the Class B Stock will receive the surplus of the Closed Block Business no longer required to support the Closed Block for regulatory purposes. Dividends on the Class B Stock are payable in an aggregate amount per year at least equal to the lesser of (1) a Target Dividend Amount of \$19.25 million or (2) the CB Distributable Cash Flow for such year, which is a measure of the net cash flows of the Closed Block Business. Notwithstanding this formula, as with any common stock, Prudential Financial will retain the flexibility to suspend dividends on the Class B Stock; however, if CB Distributable Cash Flow exists and Prudential Financial chooses not to pay dividends on the Class B Stock in an aggregate amount at least equal to the lesser of the CB Distributable Cash Flow or the Target Dividend Amount for any period, then cash dividends cannot be paid on the Common Stock with respect to such period.

Stock Conversion Rights of the Class B Stock

Prudential Financial may, at its option, at any time, exchange all outstanding shares of Class B Stock into such number of shares of Common Stock as have an aggregate average market value equal to 120% of the appraised fair market value of the outstanding shares of Class B Stock.

Holders of Class B Stock will be permitted to convert their shares of Class B Stock into such number of shares of Common Stock as have an aggregate average market value equal to 100% of the appraised fair market value of the outstanding shares of Class B Stock (1) in the holder's sole discretion, in the year 2016 or at any time thereafter, and (2) at any time in the event that (a) the Class B Stock will no longer be treated as equity of Prudential Financial for federal income tax purposes or (b) the New Jersey Department of Banking and Insurance amends, alters, changes or modifies the regulation of the Closed Block, the Closed Block Business, the Class B Stock or the IHC debt in a manner that materially adversely affects the CB Distributable Cash Flow; provided, however, that in no event may a holder of Class B Stock convert shares of Class B Stock to the extent such holder immediately upon such conversion, together with its affiliates, would be the beneficial owner (as defined under the Securities Exchange Act of 1934) of in excess of 9.9% of the total outstanding voting power of Prudential Financial's voting securities. In the event a holder of shares of Class B Stock requests to convert shares pursuant to clause (2)(a) in the preceding sentence, Prudential Financial may elect, instead of effecting such conversion, to increase the Target Dividend Amount to \$12.6875 per share per annum retroactively from the time of issuance of the Class B Stock.

Common Stock Held in Treasury

In January 2002, Prudential Financial's Board of Directors authorized a program to repurchase up to \$1 billion of Prudential Financial's outstanding Common Stock. During 2002, the Company acquired 26,027,069 shares of Common

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

13. STOCKHOLDERS' EQUITY (continued)

Stock at a total cost of \$800 million, including 1,696,929 shares at a cost of \$56 million that were immediately reissued to the Prudential Securities Incorporated ("Prudential Securities") deferred compensation program referred to in Note 15.

In March 2003, Prudential Financial's Board of Directors authorized the Company to purchase up to an additional \$1 billion of its outstanding Common Stock. During 2003, the Company acquired 29,076,809 shares of its outstanding Common Stock at a total cost of \$1.0 billion.

In March 2004, Prudential Financial's Board of Directors authorized the Company to purchase up to \$1.5 billion of its outstanding Common Stock in 2004. This stock repurchase program superseded all previous repurchase programs. During 2004, the Company acquired 32,455,600 shares of its outstanding Common Stock at a total cost of \$1.5 billion.

In November 2004, Prudential Financial's Board of Directors authorized a new stock repurchase program under which the Company is authorized to purchase up to \$1.5 billion of its outstanding Common Stock in 2005. The timing and amount of repurchases under this authorization will be determined by management based upon market conditions and other considerations, and such repurchases may be effected in the open market or through negotiated transactions. The stock repurchase program supersedes the previous repurchase program.

Common Stock held in treasury is accounted for at cost. When these shares are reissued, the balance is reduced by the average cost per share.

Comprehensive Income

The components of comprehensive income for the years ended December 31, are as follows:

	2004	2003	2002
	(in millions)		
Net income	\$2,256	\$1,264	\$ 194
Other comprehensive income, net of tax:			
Change in foreign currency translation adjustments	327	153	83
Change in net unrealized investments gains (losses)	(627)	(259)	1,606
Additional pension liability adjustment	(28)	(33)	(48)
Cumulative effect of accounting change	73	—	—
Other comprehensive income (loss), net of tax of \$(461), \$(159), \$818	(255)	(139)	1,641
Comprehensive income	<u>\$2,001</u>	<u>\$1,125</u>	<u>\$1,835</u>

The balance of and changes in each component of "Accumulated other comprehensive income (loss)" for the years ended December 31, are as follows (net of taxes):

	Accumulated Other Comprehensive Income (Loss)			
	Foreign Currency Translation Adjustments	Net Unrealized Investment Gains (Losses)	Pension Liability Adjustment	Total Accumulated Other Comprehensive Income (Loss)
	(in millions)			
Balance, December 31, 2001	\$(237)	\$1,228	\$ (47)	\$ 944
Change in component during year	83	1,606	(48)	1,641
Balance, December 31, 2002	(154)	2,834	(95)	2,585
Change in component during year	153	(259)	(33)	(139)
Balance, December 31, 2003	(1)	2,575	(128)	2,446
Change in component during year(a)	327	(554)	(28)	(255)
Balance, December 31, 2004	<u>\$ 326</u>	<u>\$2,021</u>	<u>\$(156)</u>	<u>\$2,191</u>

(a) Net unrealized investment gains (losses) for 2004 includes the impact of cumulative effect of accounting change of \$73 million.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

13. STOCKHOLDERS' EQUITY (continued)

Statutory Net Income and Surplus

Prudential Financial's U.S. insurance subsidiaries are required to prepare statutory financial statements in accordance with statutory accounting practices prescribed or permitted by the insurance department of the state of domicile. Statutory accounting practices primarily differ from GAAP by charging policy acquisition costs to expense as incurred, establishing future policy benefit liabilities using different actuarial assumptions as well as valuing investments and certain assets and accounting for deferred taxes on a different basis. Statutory net income (loss) of Prudential Insurance amounted to \$1,878 million, \$1,231 million and \$(490) million for the years ended December 31, 2004, 2003 and 2002, respectively. Statutory capital and surplus of Prudential Insurance amounted to \$8,420 million and \$7,472 million at December 31, 2004 and 2003, respectively.

14. EARNINGS PER SHARE

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

Net income for the Financial Services Businesses and the Closed Block Business is determined in accordance with 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:

	2004			2003			2002		
	(amounts in millions except per share amounts)								
	Income	Weighted Average Shares	Per Share Amount	Income	Weighted Average Shares	Per Share Amount	Income	Weighted Average Shares	Per Share Amount
Basic earnings per share									
Income from continuing operations before extraordinary gain on acquisition and cumulative effect of accounting change attributable to the Financial Services Businesses	\$1,750			\$1,083			\$755		
Direct equity adjustment	84			60			43		
Income from continuing operations before extraordinary gain on acquisition and cumulative effect of accounting change attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment	<u>\$1,834</u>	<u>520.6</u>	<u>\$3.52</u>	<u>\$1,143</u>	<u>544.4</u>	<u>\$2.10</u>	<u>\$798</u>	<u>576.6</u>	<u>\$1.38</u>
Effect of dilutive securities and compensation programs									
Stock options		4.1			1.5			0.8	
Deferred and long-term compensation programs		2.1			1.5			0.6	
Equity security units		4.4			1.0			—	
Diluted earnings per share									
Income from continuing operations before extraordinary gain on acquisition and cumulative effect of accounting change attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment	<u>\$1,834</u>	<u>531.2</u>	<u>\$3.45</u>	<u>\$1,143</u>	<u>548.4</u>	<u>\$2.08</u>	<u>\$798</u>	<u>578.0</u>	<u>\$1.38</u>

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

14. EARNINGS PER SHARE *(continued)*

For the years ended December 31, 2004, 2003 and 2002, 4.5 million, 9.3 million and 5.3 million options, respectively, weighted for the portion of the period they were outstanding, with a weighted average exercise price of \$44.94, \$31.66 and \$32.97 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

The net income (loss) attributable to the Closed Block Business available to holders of Class B Stock after direct equity adjustment for the years ended December 31, 2004, 2003 and 2002, respectively, amounted to \$498 million, \$179 million, and \$(528) million, respectively. For the years ended December 31, 2004 and 2003 the direct equity adjustment resulted in decreases of \$84 million and \$60 million in the net income attributable to the Closed Block Business applicable to holders of Class B Stock for earnings per share purposes. For the year ended December 31, 2002, the direct equity adjustment resulted in an increase in loss of \$43 million applicable to holders of the Class B Stock for earnings per share purposes. For the years ended December 31, 2004, 2003 and 2002, the weighted average number of shares of Class B Stock used in the calculation of basic earnings per share amounted to 2 million shares. There are no potentially dilutive shares associated with the Class B Stock.

15. STOCK-BASED COMPENSATION

In March 2003, the Company's Board of Directors adopted the Prudential Financial Inc. Omnibus Incentive Plan (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 Omnibus Plan provides for equity-based compensation incentives through the grant of stock options, stock appreciation rights ("SARs"), restricted stock shares, restricted stock units, and dividend equivalents, as well as cash and equity-based performance awards ("performance shares"). Any authorized shares of Common Stock not used under the Option Plan are available for the grant of awards under the Omnibus Plan. All outstanding award grants under the Option Plan continue in full force and effect, subject to the original terms under the Option Plan.

At adoption of the Omnibus Plan there were 69,543,352 authorized shares available for grant, including previously authorized but unissued shares under the Option Plan.

As of December 31, 2004, 57,856,334 authorized shares remained available for grant under the Omnibus Plan including previously authorized but unissued shares under the Option Plan.

Under the Omnibus Plan, the Company made grants of stock options, restricted stock shares, restricted stock units and performance share awards to executives. Restricted stock awards, restricted stock units, stock options and performance shares are granted to executives on a recurring basis primarily as replacements for a portion of long-term cash compensation.

Through December 31, 2004, there have been no grants of SARs.

Options

Under the Option Plan, the Company had made two types of grants, an Associates Grant and general grants (the "Executive Grants"). The Associates Grant, which occurred in December 2001, was a one-time broad based award that granted 240 stock options per full-time participant and 120 options per part-time participant. The Executive Grants, which began in 2002, are awarded to certain officers on a recurring basis primarily as replacement for a portion of long-term cash compensation. Each stock option granted under either type of grant has or will have 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 next three years. Participants are employees and non-employees (i.e., statutory agents who perform services for the Company and participating subsidiaries).

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

15. STOCK-BASED COMPENSATION (continued)

Under the Option Plan, and subsequently the Omnibus Plan, a total of 12,322,009 shares were initially authorized for the Associates Grant and a total of 30,805,024 shares were initially authorized for the Executive Grants.

Employee Stock Option Grants

A summary of the status of the Company's employee stock option grants is as follows:

	<u>Shares</u>	<u>Weighted Average Exercise Price</u>
Outstanding at December 31, 2001	11,205,960	\$27.53
Granted	10,367,694	33.53
Exercised	(45,109)	27.50
Forfeited	(2,338,522)	28.29
Expired	—	—
Transfer to non-employee status	(68,662)	27.70
Outstanding at December 31, 2002	19,121,361	30.69
Granted	8,575,698	29.66
Exercised	(1,818,239)	28.60
Forfeited	(5,009,860)	29.40
Expired	—	—
Transfer to non-employee status	(77,586)	27.55
Outstanding at December 31, 2003	20,791,374	30.77
Granted	5,258,900	44.98
Exercised	(3,144,888)	30.29
Forfeited	(1,352,841)	33.51
Expired	—	—
Transfer to non-employee status	(105,450)	27.79
Outstanding at December 31, 2004	<u>21,447,095</u>	<u>\$34.17</u>

Options exercisable were 10,277,942 shares with a weighted average exercise price of \$30.69 at December 31, 2004, 7,424,250 shares with a weighted average exercise price of \$30.21 at December 31, 2003 and 3,291,965 shares with a weighted average exercise price of \$27.72 at December 31, 2002.

Employee options granted and their related grant date weighted average fair value are as follows:

	<u>2004</u>			<u>2003</u>			<u>2002</u>		
	<u>Shares</u>	<u>Weighted Average Grant Date Fair Value</u>	<u>Weighted Average Exercise Price</u>	<u>Shares</u>	<u>Weighted Average Grant Date Fair Value</u>	<u>Weighted Average Exercise Price</u>	<u>Shares</u>	<u>Weighted Average Grant Date Fair Value</u>	<u>Weighted Average Exercise Price</u>
Exercise equals market	5,258,900	\$11.47	\$44.98	8,575,698	\$7.39	\$29.66	10,367,694	\$11.87	\$33.53
Exercise exceeds market	—	—	—	—	—	—	—	—	—
Exercise less than market	—	—	—	—	—	—	—	—	—
Total granted during the year	<u>5,258,900</u>	<u>\$11.47</u>	<u>\$44.98</u>	<u>8,575,698</u>	<u>\$7.39</u>	<u>\$29.66</u>	<u>10,367,694</u>	<u>\$11.87</u>	<u>\$33.53</u>

For options issued to employees on or after January 1, 2003, the fair value of each option was estimated on the date of grant using a binomial option-pricing model. The fair value of each option issued to employees prior to January 1, 2003 was estimated on the date of grant using a Black-Scholes option-pricing model. The weighted average assumptions used in the determination of the fair value of each option are as follows:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Dividend yield	1.20%	1.20%	1.05%
Expected volatility	25.84%	26.27%	33.33%
Risk-free interest rate	3.42%	3.01%	3.98%
Expected life of stock option	5.5 years	5.5 years	6 years

The dividend yield reflects the assumption that the current dividend payout will continue with no anticipated increases.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

15. STOCK-BASED COMPENSATION (continued)

The following table summarizes information about the employee stock options outstanding and employee stock options exercisable at December 31, 2004:

	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
Range of exercise prices:					
\$27.50 — \$29.81	4,237,218	7.15	\$27.62	3,862,453	\$27.58
\$29.90 — \$33.95	12,075,415	7.81	31.98	6,330,691	32.50
\$34.10 — \$45.00	4,958,559	9.10	44.66	84,199	37.40
\$45.18 — \$53.82	175,903	9.39	46.14	599	46.42
Total	<u>21,447,095</u>	<u>7.99</u>	<u>\$34.17</u>	<u>10,277,942</u>	<u>\$30.69</u>

Non-employee Stock Option Grants

A summary of the status of the Company's non-employee stock option grants is as follows:

	Shares	Weighted Average Exercise Price
Outstanding at December 31, 2001	813,600	\$27.50
Granted	83,980	33.96
Exercised	(2,480)	27.50
Forfeited	(99,935)	27.54
Expired	—	—
Transfer from employee status	68,662	27.70
Outstanding at December 31, 2002	863,827	28.14
Granted	163,159	28.61
Exercised	(68,100)	27.65
Forfeited	(71,116)	27.59
Expired	—	—
Transfer from employee status	77,586	27.55
Outstanding at December 31, 2003	965,356	28.25
Granted	112,707	45.92
Exercised	(354,717)	28.26
Forfeited	(69,596)	29.48
Expired	—	—
Transfer from employee status	105,450	27.79
Outstanding at December 31, 2004	<u>759,200</u>	<u>\$30.68</u>

Options exercisable were 517,978 shares with a weighted average exercise price of \$27.80 at December 31, 2004, 495,397 shares with a weighted average exercise price of \$27.85 at December 31, 2003 and 268,080 shares with a weighted average exercise price of \$27.50 at December 31, 2002. The weighted average fair value for nonvested options and options vesting during the year was \$22.19, \$14.80, and \$9.26 for the years ended December 31, 2004, 2003 and 2002, respectively.

In 2003, the Company implemented a binomial option-pricing model. The fair value of each option under the binomial model was estimated on the balance sheet date for nonvested options and on the vesting date for any option vesting during 2003 and 2004. Prior to January 1, 2003, the fair value of each option was estimated on the balance sheet date for nonvested options and on the vesting date for vested options using a Black-Scholes option-pricing model. The weighted average assumptions used in the determination of the fair value of each option are as follows:

	2004	2003	2002
Dividend yield	1.20%	1.20%	1.30%
Expected volatility	25.84%	26.27%	35.60%
Risk-free interest rate	3.10%	2.47%	2.15%
Expected life of stock option	3.33 years	3.20 years	3.21 years

The dividend yield reflects the assumption that the current dividend payout will continue with no anticipated increases.

PRUDENTIAL FINANCIAL, INC.
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15. STOCK-BASED COMPENSATION (continued)

The compensation expense recognized for stock-based non-employee compensation awards was \$6 million, \$5 million, and \$4 million for the years ended December 31, 2004, 2003 and 2002, respectively.

The following table summarizes information about the non-employee stock options outstanding and exercisable at December 31, 2004:

	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
Range of exercise prices:					
\$27.50 — \$29.90	604,302	7.23	\$27.71	499,305	\$27.55
\$30.96 — \$33.95	44,665	7.54	33.72	16,552	33.77
\$34.24 — \$46.42	110,233	9.13	45.75	2,121	40.15
Total	<u>759,200</u>	<u>7.53</u>	<u>\$30.68</u>	<u>517,978</u>	<u>\$27.80</u>

Restricted Stock Shares, Restricted Stock Units and Performance Share Awards

A restricted stock share represents a grant of Common Stock to employee and non-employee participants that is subject to certain transfer restrictions and forfeiture provisions for a specified period of time. A restricted stock unit is an unfunded, unsecured right to receive a share of Common Stock at the end of a specified period of time, which is also subject to forfeiture and transfer restrictions. Generally, the restrictions on restricted stock shares and restricted stock units will lapse on the third anniversary of the date of grant. Restricted stock shares subject to the transfer restrictions and forfeiture provisions are considered nonvested shares. Nonvested shares forfeited by participants revert to the Company and are reflected as Common Stock held in treasury as of the date of forfeiture.

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.

Restricted stock shares, restricted stock units and performance shares are primarily awarded as a portion of long-term compensation. The following tables summarize awards granted, weighted average price and nonvested awards for restricted stock shares, restricted stock units and performance shares for the periods indicated:

	2004				
	Awards Granted			Weighted Average Grant Date Price	Weighted Average Balance Sheet Date Price
	Employee	Non-Employee	Total	Employee	Non-Employee
Restricted stock shares	1,376,892	10,629	1,387,521	\$44.96	\$54.96
Restricted stock units	94,084	844	94,928	45.00	54.96
Performance shares(a)	502,545	—	502,545	44.93	—
Total	<u>1,973,521</u>	<u>11,473</u>	<u>1,984,994</u>	<u>\$44.95</u>	<u>\$54.96</u>

	2003				
	Awards Granted			Weighted Average Grant Date Price	Weighted Average Balance Sheet Date Price
	Employee	Non-Employee	Total	Employee	Non-Employee
Restricted stock shares	1,917,152	13,946	1,931,098	\$33.66	\$41.77
Restricted stock units	139,452	—	139,452	33.61	—
Performance shares(a)	236,933	—	236,933	33.61	—
Total	<u>2,293,537</u>	<u>13,946</u>	<u>2,307,483</u>	<u>\$33.65</u>	<u>\$41.77</u>

- (a) Performance shares reflect the target awarded, reduced for cancellations and releases 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.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

15. STOCK-BASED COMPENSATION (continued)

The weighted average price of employee restricted stock shares, restricted stock units, and performance shares is based on the quoted fair value of the Company's Common Stock on the date of grant. The weighted average price of non-employee restricted stock shares is based on the Company's Common Stock price at the balance sheet date.

Compensation cost of awards is based on the weighted average price for each award and is recorded as expense over the vesting period which is typically three years. The compensation expense recognized for employee and non-employee restricted stock shares was \$34 million and \$19 million for the years ended December 31, 2004 and 2003, respectively. The compensation expense recognized for employee restricted stock units and performance shares combined was \$18 million and \$4 million for the years ended December 31, 2004 and 2003, respectively.

Nonvested Shares at December 31, 2004			
	Employee	Non-Employee	Total
Restricted stock shares	2,689,264	22,867	2,712,131
Restricted stock units	221,951	844	222,795
Performance shares(a)	726,377	—	726,377
Total	<u>3,637,592</u>	<u>23,711</u>	<u>3,661,303</u>

- (a) Performance shares reflect the target awarded, reduced for cancellations and releases 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.

Deferred Compensation Program

Prior to the contribution of the Company's retail securities brokerage and clearing operations into the joint venture with Wachovia on July 1, 2003, the Company maintained a deferred compensation program for Financial Advisors and certain other employees (the "participants") of the contributed operations, under which participants elected to defer a portion of their compensation. Amounts deposited to participant accounts, including matching contributions as well as other amounts based on the attainment of specific performance goals, vest in 3 to 8 years. Nonvested balances are forfeited if the participant is terminated for cause or voluntarily terminates prior to the vesting date. In 2002, participants were permitted to elect to redeem all or a portion of their existing nonvested account balances and invest the proceeds in Prudential Financial Common Stock. Accordingly, the Company acquired, on behalf of the participants electing to participate, 1,696,929 shares of Common Stock at a total cost of \$56 million. On the date the account balances were converted to Common Stock, related remaining deferred compensation expense of \$29 million, which is being amortized over the vesting period, was recorded as a reduction in stockholders' equity. The deferred compensation expense of \$14 million, as of July 1, 2003, was included in the net assets of the Company's retail securities brokerage and clearing operations contributed to the joint venture with that of Wachovia. The results of operations of the joint venture, of which the Company owns a 38% interest, will include the amortization of the deferred compensation expense. As of December 31, 2004, there were 356,291 nonvested shares in participants accounts. The Company continues to repurchase forfeited shares from the joint venture, which are reflected as Common Stock held in treasury as of the date of forfeiture.

16. EMPLOYEE BENEFIT PLANS

Pension and Other Postretirement Plans

The Company has funded and non-funded contributory and non-contributory defined benefit pension plans, which cover substantially all of its employees. For some employees, benefits are based on final average earnings and length of service, while benefits for other employees are based on 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. The Company has elected to amortize its transition obligation for other postretirement benefits over 20 years.

PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

16. EMPLOYEE BENEFIT PLANS *(continued)*

On December 8, 2003, President Bush signed the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 ("the Act") into law. The Act introduces a prescription drug benefit under Medicare (Medicare Part D) beginning in 2006. Under the Act, employers who sponsor postretirement plans that provide prescription drug benefits that are actuarially equivalent to Medicare qualify to receive subsidy payments.

On January 12, 2004, the FASB issued FSP 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement, and Modernization Act of 2003." As permitted by FSP 106-1, the Company elected to defer the accounting for the effects of the Act in 2003.

On May 19, 2004, the FASB issued FSP 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement, and Modernization Act of 2003." In accordance with FSP 106-2, the Company remeasured its plan assets and Accumulated Postretirement Benefit Obligation ("APBO") as of January 1, 2004 to account for the subsidy and other effects of the Act. This remeasurement resulted in a \$39 million reduction in postretirement benefit costs in 2004. The \$39 million reduction in postretirement benefit costs reflects \$33 million as a result of the subsidy and is comprised of a \$18 million reduction in the amortization of actuarial loss, a \$15 million reduction in interest costs, and a \$0 million reduction in service cost. The reduction in the APBO for the subsidy related to past service was \$337 million.

Prepaid and accrued benefits costs are included in "Other assets" and "Other liabilities," respectively, in the Company's Consolidated Statements of Financial Position. The status of these plans as of September 30, adjusted for fourth-quarter activity, is summarized below:

	Pension Benefits		Other Postretirement Benefits	
	2004	2003	2004	2003
	(in millions)			
Change in benefit obligation				
Benefit obligation at the beginning of period	\$(7,789)	\$(7,570)	\$(2,859)	\$(2,434)
Service cost	(147)	(180)	(10)	(14)
Interest cost	(416)	(444)	(148)	(152)
Plan participants' contributions	(1)	(1)	(15)	(11)
Amendments	—	(17)	(13)	73
Annuity purchase	3	3	—	—
Actuarial gains/(losses), net	27	(645)	146	(559)
Settlements	4	436	—	—
Curtailments	1	130	—	1
Contractual termination benefits	—	(1)	—	—
Special termination benefits	—	(61)	—	(1)
Benefits paid	773	642	211	171
Foreign currency changes	(42)	(81)	(2)	(4)
Divestiture	—	—	—	71
Benefit obligation at end of period	<u>\$(7,587)</u>	<u>\$(7,789)</u>	<u>\$(2,690)</u>	<u>\$(2,859)</u>
Change in plan assets				
Fair value of plan assets at beginning of period	\$ 8,731	\$ 7,914	\$ 1,131	\$ 1,156
Actual return on plan assets	1,195	1,391	112	128
Annuity purchase	(3)	(3)	—	—
Employer contributions	89	74	9	8
Plan participants' contributions	1	1	15	10
Contributions for settlements	1	423	—	—
Disbursement for settlements	(4)	(436)	—	—
Benefits paid	(773)	(642)	(211)	(171)
Foreign currency changes	9	9	—	—
Fair value of plan assets at end of period	<u>\$ 9,246</u>	<u>\$ 8,731</u>	<u>\$ 1,056</u>	<u>\$ 1,131</u>
Funded status				
Funded status at end of period	\$ 1,659	\$ 942	\$(1,634)	\$(1,728)
Unrecognized transition (asset) liability	—	(23)	5	6
Unrecognized prior service costs	157	181	(54)	(74)
Unrecognized actuarial losses, net	1,001	1,428	659	866
Effects of fourth quarter activity	12	9	3	1
Net amount recognized	<u>\$ 2,829</u>	<u>\$ 2,537</u>	<u>\$(1,021)</u>	<u>\$ (929)</u>

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

16. EMPLOYEE BENEFIT PLANS *(continued)*

	Pension Benefits		Other Postretirement Benefits	
	2004	2003	2004	2003
	(in millions)			
Amounts recognized in the Statements of Financial Position				
Prepaid benefit cost	\$ 3,689	\$ 3,328	\$ —	\$ —
Accrued benefit liability	(1,100)	(1,003)	(1,021)	(929)
Intangible asset	12	17	—	—
Accumulated other comprehensive income	228	195	—	—
Net amount recognized	<u>\$ 2,829</u>	<u>\$ 2,537</u>	<u>\$(1,021)</u>	<u>\$ (929)</u>
Accumulated benefit obligation	<u>\$(7,299)</u>	<u>\$(7,249)</u>	<u>\$(2,690)</u>	<u>\$(2,859)</u>

Pension benefits for foreign plans comprised 9% and 7% of the ending benefit obligation for 2004 and 2003, respectively. Foreign plans comprised 1% and 1% of the ending fair value of market assets for 2004 and 2003, respectively. There are no foreign postretirement plans.

The projected benefit obligations, accumulated benefit obligations and fair value of plan assets for the pension plans with accumulated benefit obligations in excess of plan assets were \$1,305 million, \$1,186 million and \$124 million, respectively, at September 30, 2004 and \$1,195 million, \$1,057 million and \$88 million, respectively, at September 30, 2003.

In 2004 and 2003, the pension plan purchased annuity contracts from Prudential Insurance for \$3 million and \$3 million, respectively. The approximate future annual benefit payment for all annuity contracts was \$23 million and \$22 million in 2004 and 2003, respectively.

There were no material pension amendments in 2004. The benefit obligation for pensions increased by \$17 million in 2003 for the inclusion of a new non-qualified pension plan for mid-career hires.

The benefit obligation for other postretirement benefits increased by \$13 million in 2004 for changes in the substantive plan made to medical, dental and life insurance benefits. There was an increase in cost of \$11 million related to cost sharing changes for certain retirees for medical benefits. There was also an increase in cost of \$2 million associated with providing Prudential Financial benefits to employees of Cigna Life that were brought into Prudential Financial postretirement plans reflected at the January 1, 2004 remeasurement with credit for prior service. The benefit obligation for other postretirement benefits decreased by \$73 million in 2003 for changes in the substantive plan made to medical, dental and life insurance benefits. There was a reduction in cost related to changes in the prescription drug program of \$39 million and a reduction of \$39 million for cost sharing shifts to certain retirees for medical and dental benefits. There was an increase in cost of \$5 million associated with providing Prudential Financial benefits to former Prudential Securities employees that transferred to Prudential Financial effective July 1, 2003.

The pension benefits were amended during the time period presented for 2002 to provide contractual termination benefits to certain plan participants whose employment had been terminated. Costs related to these amendments are reflected in contractual termination benefits in the table below.

Employees were provided special termination benefits in conjunction with their termination of employment related to the Prudential Securities and Prudential Property and Casualty transactions in 2003. These benefits include the cost of vesting plan participants, accruing benefits until year-end, crediting service for vesting purposes and certain early retirement subsidies. Costs related to these amendments are reflected in special termination benefits in the table below.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

16. EMPLOYEE BENEFIT PLANS (continued)

Net periodic (benefit) cost included in “General and administrative expenses” in the Company’s Consolidated Statements of Operations for the years ended December 31, includes the following components:

	Pension Benefits			Other Postretirement Benefits		
	2004	2003	2002	2004	2003	2002
	(in millions)					
Components of net periodic (benefit) cost						
Service cost	\$ 147	\$ 180	\$ 175	\$ 10	\$ 14	\$ 14
Interest cost	416	444	463	148	152	152
Expected return on plan assets	(831)	(839)	(913)	(81)	(83)	(114)
Amortization of transition amount	(23)	(106)	(106)	1	3	17
Amortization of prior service cost	25	29	30	(7)	(1)	—
Amortization of actuarial (gain) loss, net	23	14	(45)	28	10	(10)
Settlements	—	16	—	—	—	—
Curtailments	—	31	—	—	—	—
Contractual termination benefits	(1)	—	1	—	—	—
Special termination benefits	—	61	—	—	1	—
Net periodic (benefit) cost	<u>\$ (244)</u>	<u>\$ (170)</u>	<u>\$ (395)</u>	<u>\$ 99</u>	<u>\$ 96</u>	<u>\$ 59</u>

The increase in the minimum liability included in “Accumulated other comprehensive income” as of September 30, 2004 and September 30, 2003 is as follows:

	Pension Benefits		Other Postretirement Benefits	
	2004	2003	2004	2003
	(in millions)			
Increase in minimum liability included in other comprehensive income	\$33	\$59	\$—	\$—

The assumptions as of September 30, used by the Company to calculate the domestic benefit obligations as of that date and to determine the benefit cost in the year are as follows:

	Pension Benefits			Other Postretirement Benefits		
	2004	2003	2002	2004	2003	2002
Weighted-average assumptions						
Discount rate (beginning of period)	5.75%	6.50%	7.25%	5.75%	6.50%	7.25%
Discount rate (end of period)	5.75%	5.75%	6.50%	5.50%	5.75%	6.50%
Rate of increase in compensation levels (beginning of period)	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
Rate of increase in compensation levels (end of period)	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
Expected return on plan assets (beginning of period)	8.75%	8.75%	9.50%	7.75%	7.75%	9.00%
Health care cost trend rates (beginning of period)	—	—	—	6.05–10.00%	6.40–10.00%	6.76–8.76%
Health care cost trend rates (end of period)	—	—	—	5.44–10.00%	6.05–10.00%	6.40–10.00%
For 2004, 2003 and 2002, the ultimate health care cost trend rate after gradual decrease until: 2009, 2007, 2007 (beginning of period)	—	—	—	5.00%	5.00%	5.00%
For 2004, 2003 and 2002, the ultimate health care cost trend rate after gradual decrease until: 2009, 2007, 2007 (end of period)	—	—	—	5.00%	5.00%	5.00%

The assumptions for foreign pension plans are based on local markets. There are no foreign postretirement plans.

The pension and postretirement expected long term rates of return for 2004 were determined based upon an approach that considered an expectation of the allocation of plan assets during the measurement period of 2004. Expected returns are estimated by asset class as noted in the discussion of investment policies and strategies below. The expected returns by an asset class contemplate the risk free interest rate environment as of the measurement date and then add a risk premium. The risk premium is a range of percentages and is based upon historical information and other factors such as expected reinvestment returns and asset manager performance.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

16. EMPLOYEE BENEFIT PLANS (continued)

The Company applied the same approach to the determination of the expected long term rate of return in 2005. The expected long term rate of return for 2005 is 8.50% and 8.25%, respectively, for the pension and postretirement plans.

The Company, with respect to pension benefits, uses market related value to determine the components of net periodic benefit cost. Market related value is a measure of asset value that reflects the difference between actual and expected return on assets over a five year period.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plan. A one-percentage point increase and decrease in assumed health care cost trend rates would have the following effects:

	Other Postretirement Benefits
	2004
	(in millions)
One percentage point increase	
Increase in total service and interest costs	\$ 12
Increase in postretirement benefit obligation	209
One percentage point decrease	
Decrease in total service and interest costs	\$ 10
Decrease in postretirement benefit obligation	178

Pension and postretirement plan asset allocation as of September 30, 2004 and September 30, 2003, are as follows:

Asset category	Pension Percentage of Plan Assets as of September 30		Postretirement Percentage of Plan Assets as of September 30	
	2004	2003	2004	2003
U.S. Stocks	41%	49%	58%	52%
International Stocks	12%	9%	6%	5%
Bonds	39%	34%	22%	20%
Short-term Investments	0%	2%	3%	3%
Real Estate	6%	6%	0%	0%
Municipal Bonds	0%	0%	11%	20%
Other	2%	0%	0%	0%
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

The Company, for its domestic pension and postretirement plans, has developed guidelines for asset allocations. As of the September 30, 2004 measurement date the range of target percentages are as follows:

Asset category	Pension Investment Policy Guidelines as of September 30, 2004		Postretirement Investment Policy Guidelines as of September 30, 2004	
	Minimum	Maximum	Minimum	Maximum
U.S. Stocks	30%	51%	28%	68%
International Stocks	5%	16%	1%	8%
Bonds	42%	68%	11%	50%
Short-term Investments	0%	21%	0%	29%
Real Estate	2%	7%	0%	3%
Municipal Bonds	0%	0%	12%	12%
Other	0%	10%	0%	0%

Management reviews its investment strategy on an annual basis.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

16. EMPLOYEE BENEFIT PLANS *(continued)*

The investment goal of the domestic pension plan assets is to generate an above benchmark return on a diversified portfolio of stocks, bonds and real estate, while meeting the cash requirements for a pension obligation that includes a traditional formula principally representing payments to annuitants and a cash balance formula that allows lump sum payments and annuity payments. The pension plan risk management practices include guidelines for asset concentration, credit rating and liquidity. The pension plan does not invest in leveraged derivatives. Derivatives such as futures contracts are used to reduce transaction costs and change asset concentration.

The investment goal of the domestic postretirement plan assets is to generate an above benchmark return on a diversified portfolio of stocks, real estate, bonds and municipal bonds, while meeting the cash requirements for the postretirement obligations that includes a medical benefit including prescription drugs, a dental benefit and a life benefit. The postretirement equity is used to provide expected growth in assets deposited into the plan assets. Bonds provide liquidity and income. Real estate provides for capital growth and income. Short-term investments provide liquidity and allow for defensive asset mixes. Municipal bonds provide liquidity and tax efficient income, where appropriate. The postretirement plans risk management practices include guidelines for asset concentration, credit rating, liquidity, and tax efficiency. The postretirement plan does not invest in leveraged derivatives. Derivatives such as futures contracts are used to reduce transaction costs and change asset concentration.

There were no investments in Prudential Financial Common Stock as of September 30, 2004 or 2003 for either the pension or postretirement plans. Pension plan assets of \$7,161 million and \$7,311 million are included in Separate Account assets and liabilities as of September 30, 2004 and 2003, respectively.

The expected benefit payments for the Company's domestic pension and postretirement plans for the years indicated are as follows:

	Pension	Other Postretirement Benefits	Other Postretirement Benefits Subsidy Receipt
		(in millions)	
2005	\$ 458	\$ 238	\$ —
2006	455	247	18
2007	458	253	19
2008	461	255	20
2009	464	255	21
2010-2014	2,423	1,267	121
Total	<u>\$4,719</u>	<u>\$2,515</u>	<u>\$ 199</u>

The Company anticipates that it will make cash contributions in 2005 of \$73 million to the pension plans and \$10 million to the postretirement plans.

Postemployment Benefits

The Company accrues postemployment benefits primarily for life and health benefits provided to former or inactive employees who are not retirees. The net accumulated liability for these benefits at December 31, 2004 and 2003 was \$62 million and \$52 million, respectively, and is included in "Other liabilities."

Other Employee Benefits

The Company sponsors voluntary savings plans for employees (401(k) plans). The plans provide for salary reduction contributions by employees and matching contributions by the Company of up to 4% of annual salary. The matching contributions by the Company included in "General and administrative expenses" were \$52 million, \$54 million and \$55 million for the years ended December 31, 2004, 2003 and 2002, respectively.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

17. INCOME TAXES

The components of income tax expense (benefit) for the years ended December 31, were as follows:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
	(in millions)		
Current tax expense (benefit)			
U.S.	\$497	\$108	\$(124)
State and local	23	23	2
Foreign	81	38	32
Total	<u>601</u>	<u>169</u>	<u>(90)</u>
Deferred tax expense (benefit)			
U.S.	54	143	(238)
State and local	(26)	43	(61)
Foreign	326	302	201
Total	<u>354</u>	<u>488</u>	<u>(98)</u>
Total income tax expense (benefit)	<u>\$955</u>	<u>\$657</u>	<u>\$(188)</u>

The Company's actual income tax expense (benefit) for the years ended December 31, differs from the expected amount computed by applying the statutory federal income tax rate of 35% to income from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change for the following reasons:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
	(in millions)		
Expected federal income tax expense	\$1,151	\$693	\$ 30
Assumed repatriation of foreign earnings	—	120	—
Disposition of subsidiaries	—	(78)	(183)
Non-taxable investment income	(149)	(72)	(116)
State and local income taxes	(9)	43	(41)
Non-deductible expenses	6	(12)	40
Valuation allowance	(24)	(2)	37
Other	(20)	(35)	45
Total income tax expense (benefit)	<u>\$ 955</u>	<u>\$657</u>	<u>\$(188)</u>

Deferred tax assets and liabilities at December 31, resulted from the items listed in the following table:

	<u>2004</u>	<u>2003</u>
	(in millions)	
Deferred tax assets		
Insurance reserves	\$ 1,314	\$ 1,282
Policyholder dividends	1,207	1,230
Net operating and capital loss carryforwards	1,118	263
Other	1,548	791
Deferred tax assets before valuation allowance	5,187	3,566
Valuation allowance	(677)	(230)
Deferred tax assets after valuation allowance	<u>4,510</u>	<u>3,336</u>
Deferred tax liabilities		
Net unrealized investment gains	2,951	3,166
Deferred policy acquisition costs	2,249	1,943
Employee benefits	365	253
Other	990	82
Deferred tax liabilities	<u>6,555</u>	<u>5,444</u>
Net deferred tax liability	<u>\$(2,045)</u>	<u>\$(2,108)</u>

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

17. INCOME TAXES (continued)

Management believes that based on its historical pattern of taxable income, the Company will produce sufficient income in the future to realize its deferred tax asset after valuation allowance. A valuation allowance has been recorded primarily related to tax benefits associated with foreign operations and state and local deferred tax assets. The valuation allowance as of December 31, 2004 includes \$443 million recorded in connection with the acquisition of Hyundai.

Adjustments to the valuation allowance will be made if there is a change in management's assessment of the amount of the deferred tax asset that is realizable. At December 31, 2004 and 2003, respectively, the Company had federal net operating and capital loss carryforwards of \$874 million and \$170 million, which expire between 2007 and 2024. At December 31, 2004 and 2003, respectively, the Company had state operating and capital loss carryforwards for tax purposes approximating \$2,655 million and \$5,160 million, which expire between 2007 and 2024. At December 31, 2004 and 2003, respectively, the Company had foreign operating loss carryforwards for tax purposes approximating \$2,090 million and \$35 million, \$2,066 million of which expires between 2005 and 2011 and \$24 million of which have an unlimited carryforward.

During the third quarter of 2004, the Company completed a review of its deferred tax accounts relating to Gibraltar Life that identified a miscalculation of deferred tax assets before valuation allowance. As a result, deferred tax assets before valuation allowance at April 1, 2001 (Gibraltar Life's acquisition date) have been increased by approximately \$130 million. Analysis of the recoverability of these tax benefits as of the same date caused the Company to record a valuation allowance in a substantially equivalent amount, resulting in no material change in net deferred tax assets as of that date.

The Company previously had not provided U.S. income taxes on unremitted foreign earnings of its non-U.S. operations because such earnings had been considered to be permanently reinvested in such operations. During 2003, the Company determined that earnings from companies in high tax jurisdictions will be repatriated to the U.S. Accordingly, earnings from its Japanese insurance operations and German investment management subsidiaries are no longer considered permanently reinvested. The U.S. income tax benefit of \$31 million associated with the assumed repatriation of 2004 earnings has been recognized. The Company has undistributed earnings of foreign subsidiaries, other than its Japanese insurance operations and German investment management subsidiaries, of \$862 million and \$674 million at December 31, 2004 and 2003, respectively, for which deferred taxes have not been provided. Such earnings are considered permanently invested in the foreign subsidiaries. Determining the tax liability that would arise if these earnings were remitted is not practicable.

On October 22, 2004, the American Jobs Creation Act ("the AJCA") was signed into law. The AJCA includes a deduction of 85% of certain foreign earnings that are repatriated, as defined in the AJCA. The Company may elect to apply this provision to qualifying earning repatriations during 2005. The Company has started an evaluation of the effects of the repatriation provision; however, the Company does not expect to be able to substantially complete any aspect of this evaluation earlier than the second quarter of 2005 and the evaluation of the effects of the repatriation provision will likely be assessed throughout 2005. The maximum allowable amount to be considered for repatriation under the laws applicable to the Company is \$2.24 billion (which is the amount of unrepatriated earnings as disclosed in the Company's 2002 financial statements); however, the Company is unable to reasonably estimate what portion, if any, of this amount the Company may repatriate. Similarly, the Company is unable to reasonably estimate the related potential range of income tax benefit or expense.

The Internal Revenue Service (the "Service") has completed all examinations of the consolidated federal income tax returns through 1996. Tax years 1997 through 2001 are currently under examination by the Service. Management believes sufficient provisions have been made for potential adjustments.

18. FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair values presented below have been determined by using available market information and by applying valuation methodologies. Considerable judgment is applied in interpreting data to develop the estimates of fair value. These fair values may not be realized in a current market exchange. The use of different market assumptions and/or estimation methodologies could have a material effect on the fair values. The methods and assumptions discussed below were used in calculating the fair values of the instruments. See Note 19 for a discussion of derivative instruments.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

18. FAIR VALUE OF FINANCIAL INSTRUMENTS *(continued)*

Fixed Maturities

The fair values of public fixed maturity securities are based on quoted market prices or estimates from independent pricing services. However, for investments in private placement fixed maturity securities, this information is not available. For these private investments, the fair value is determined typically by using a discounted cash flow model, which considers current market credit spreads for publicly traded issues with similar terms by companies of comparable credit quality, and an additional spread component for the reduced liquidity associated with private placements. This additional spread component is determined based on surveys of various third party financial institutions. Historically, changes in estimated future cash flows or the assessment of an issuer's credit quality have been the more significant factors in determining fair values.

Commercial Loans

The fair value of commercial loans is primarily based upon the present value of the expected future cash flows discounted at the appropriate U.S. Treasury rate or Japanese Government Bond rate for yen based loans, adjusted for the current market spread for similar quality loans.

Policy Loans

The fair value of U.S. insurance policy loans is calculated using a discounted cash flow model based upon current U.S. Treasury rates and historical loan repayment patterns, while Japanese insurance policy loans use the risk-free proxy based on the Yen Libor.

Mortgage Brokerage-Loan Inventory

The fair value of the mortgage brokerage-loan inventory is based upon various factors, including the terms of the loans, the intended exit strategy for the loans based upon either a securitization pricing model or commitments from investors, prevailing interest rates, and credit risk.

Investment Contracts

For guaranteed investment contracts, income annuities and other similar contracts without life contingencies, fair values are derived using discounted projected cash flows based on interest rates being offered for similar contracts with maturities consistent with those of the contracts being valued. For individual deferred annuities and other deposit liabilities, carrying value approximates fair value.

Debt

The fair value of short-term and long-term debt is derived by using discount rates based on the borrowing rates currently available to the Company for debt and financial instruments with similar terms and remaining maturities.

The carrying amount approximates or equals fair value for the following instruments: fixed maturities classified as available for sale, equity securities, short-term investments, cash and cash equivalents, restricted cash and securities, separate account assets and liabilities, trading account assets supporting insurance liabilities, other trading account assets, broker-dealer related receivables/payables, securities purchased under agreements to resell, securities sold under agreements to repurchase, cash collateral for loaned securities, and securities sold but not yet purchased. The following table discloses the Company's financial instruments where the carrying amounts and fair values differ at December 31,

	2004		2003	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(in millions)			
Fixed maturities, held to maturity	\$ 2,747	\$ 2,765	\$ 3,068	\$ 3,084
Commercial loans	24,389	25,549	19,469	21,037
Policy loans	8,373	9,794	8,152	9,706
Mortgage brokerage-loan inventory	985	993	1,056	1,058
Investment contracts	63,569	64,064	40,681	41,450
Short-term and long-term debt	11,671	12,271	10,349	10,844

PRUDENTIAL FINANCIAL, INC.
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19. DERIVATIVE INSTRUMENTS

Types of Derivative Instruments

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

Exchange-traded futures and options are used by the Company to reduce market risks from changes in interest rates, to alter mismatches between the duration of assets in a portfolio and the duration of liabilities supported by those assets, and to hedge against changes in the value of securities it owns or anticipates acquiring or selling. In exchange-traded futures transactions, the Company agrees to purchase or sell a specified number of contracts, the values of which are determined by the values of designated classes of securities, and to post variation margin on a daily basis in an amount equal to the difference in the daily market values of those contracts. The Company enters into exchange-traded futures and options with regulated futures commissions merchants who are members of a trading exchange.

Futures typically are used to hedge duration mismatches between assets and liabilities. Futures move substantially in value as interest rates change and can be used to either modify or hedge existing interest rate risk. This strategy protects against the risk that cash flow requirements may necessitate liquidation of investments at unfavorable prices resulting from increases in interest rates. This strategy can be a more cost effective way of temporarily reducing the Company's exposure to a market decline than selling fixed income securities and purchasing a similar portfolio when such a decline is believed to be over.

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

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

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

Credit derivatives are used by the Company to enhance the return on the Company's investment portfolio by providing comparable exposure to fixed income securities that might not be available in the primary market. They are also used to hedge credit exposures in the Company's investment portfolio. With credit derivatives the Company can sell or buy credit protection on an identified name or names in return for receiving or paying a quarterly premium. This premium generally corresponds to a referenced name's credit spread at the time the agreement is executed. When selling protection, if there is an

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

19. DERIVATIVE INSTRUMENTS *(continued)*

event of default by the referenced name, as defined by the agreement, then the Company is obligated to pay the counterparty the referenced amount of the contract and receive in return the referenced security. See Note 21 for a discussion of guarantees related to these credit derivatives.

Forward contracts are used by the Company to manage market risks relating to interest rates. The Company also uses “to be announced” (“TBA”) forward contracts to gain exposure to the investment risk and return of mortgage-backed securities. TBA transactions can help the Company to achieve better diversification and to enhance the return on its investment portfolio. TBAs provide a more liquid and cost effective method of achieving these goals than purchasing or selling individual mortgage-backed pools. Typically, the price is agreed upon at the time of the contract and payment for such a contract is made at a specified future date.

When the Company has cash flows that it has allocated for investment in equity securities or plans to sell investments in equity securities, it may enter into equity derivatives as a temporary hedge against an increase or decrease in the price of the securities it intends to purchase or sell. These hedges are intended to permit such investment transactions to be executed with less adverse market impacts. The Company also may use equity-based derivatives to hedge the equity risks embedded in some of its annuity products.

Cash Flow, Fair Value and Net Investment Hedges

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

The ineffective portion of derivatives accounted for using hedge accounting in the years ended December 31, 2004, 2003 and 2002 was not material to the results of operations of the Company. In addition, there were no instances in which the Company discontinued cash flow hedge accounting because the forecasted transaction did not occur by the anticipated date or within the additional time period permitted by SFAS No. 133.

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

	(in millions)
Balance, December 31, 2001	\$ (16)
Net deferred gains on cash flow hedges from January 1 to December 31, 2002	40
Amount reclassified into current period earnings	(27)
Balance, December 31, 2002	(3)
Net deferred losses on cash flow hedges from January 1 to December 31, 2003	(90)
Amount reclassified into current period earnings	(18)
Balance, December 31, 2003	(111)
Net deferred losses on cash flow hedges from January 1 to December 31, 2004	(146)
Amount reclassified into current period earnings	47
Balance, December 31, 2004	<u><u>\$(210)</u></u>

It is anticipated that a pre-tax gain of approximately \$16 million will be reclassified from “Accumulated other comprehensive income (loss)” to earnings during the year ended December 31, 2005, offset by amounts pertaining to the hedged items. As of December 31, 2004, the Company does not have any cash flow hedges of forecasted transactions other than those related to the variability of the payment or receipt of interest or foreign currency amounts on existing financial instruments. The maximum length of time for which these variable cash flows are hedged is 19 years. Income amounts deferred in “Accumulated other comprehensive income (loss)” as a result of cash flow hedges are included in “Net unrealized investment gains (losses)” in the Consolidated Statements of Stockholders’ Equity.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

19. DERIVATIVE INSTRUMENTS *(continued)*

For effective net investment hedges, the amounts, before applicable taxes, recorded in the cumulative translation adjustment account within “Accumulated other comprehensive income (loss)” were losses of \$147 million, \$84 million and \$67 million in 2004, 2003 and 2002, respectively.

For the years ended December 31, 2004, 2003 and 2002, there were no derivative reclassifications to earnings due to hedged firm commitments no longer deemed probable or due to hedged forecasted transactions that had not occurred by the end of the originally specified time period.

Credit Risk

The Company is exposed to credit-related losses in the event of nonperformance by counterparties to derivative financial instruments. Generally, the current credit exposure of the Company’s derivative contracts is limited to the fair value at the reporting date. The credit exposure of the Company’s over-the-counter derivative transactions is represented by the fair value (market value) of contracts with a positive fair value (market value) at the reporting date. Because exchange-traded futures and options are effected through regulated exchanges, and positions are marked to market on a daily basis, the Company has little exposure to credit-related losses in the event of nonperformance by counterparties to such financial instruments.

The Company manages credit risk by entering into transactions with creditworthy counterparties and obtaining collateral where appropriate and customary. In addition, the Company enters into over-the-counter swaps pursuant to master agreements that provide for a single net payment to be made by one counterparty to another at each due date and upon termination. Likewise, the Company effects exchange-traded futures and options through regulated exchanges and these positions are marked to market on a daily basis.

20. 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. Businesses that are not sufficiently material to warrant separate disclosure and businesses to be divested are included in Corporate and Other operations. Collectively, the businesses that comprise the three operating divisions and Corporate and Other are referred to as the Financial Services Businesses.

Insurance Division. The Insurance division consists of the Individual Life and Annuities and Group Insurance segments. The Individual Life and Annuities segment manufactures and distributes individual variable life, term life, universal life, non-participating whole life insurance, and variable and fixed annuity products, primarily to the U.S. market. The Group Insurance segment manufactures and distributes a full range of group life, long-term and short-term group disability, long-term care and corporate-owned and trust-owned life insurance products in the U.S. to institutional clients primarily for use in connection with employee and membership benefit plans.

Investment Division. The Investment division consists of the Asset Management, Financial Advisory and Retirement segments. In 2004, the Company combined the former Other Asset Management segment and the former Investment Management segment to form the Asset Management segment. The Asset Management segment provides a broad array of investment management and advisory services, mutual funds and other structured products. These products and services are marketed and provided to the public and private marketplace in addition to other segments of the Company. The Financial Advisory segment includes, effective July 1, 2003, the equity method investment in Wachovia Securities. This segment also includes the equity sales, trading and research operations. The Retirement segment manufactures and distributes products and provides administrative services for qualified and non-qualified retirement plans and offers guaranteed investment contracts, funding agreements, retail notes, structured settlement annuities and group annuities.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

20. SEGMENT INFORMATION *(continued)*

International Insurance and Investments Division. The International Insurance and Investments division consists of the International Insurance and International Investments segments. The International Insurance segment manufactures and distributes individual life insurance products to the mass affluent and affluent markets in Japan, Korea and other foreign countries through Life Planners. In addition, similar products are offered to the broad middle income market across Japan through Life Advisors, the proprietary distribution channel of the Company's Gibraltar Life operations. The International Investments segment offers asset management, investment advice and product choice services to high net worth and mass affluent retail clients and to institutional clients in selected international markets.

Corporate and Other. Corporate and Other operations include corporate-level activities that are not allocated to business segments and the real estate and relocation services operations, as well as certain wind-down and divested businesses. Wind-down businesses include individual health insurance and Canadian life insurance. The divested businesses consist primarily of the Dryden Wealth Management business, property and casualty insurance business, Prudential Securities capital markets and Gibraltar Casualty Company. Corporate-level activities include corporate-level income and expenses not allocated to any business segments, including the cost of company-wide initiatives, income from the Company's qualified pension plan, investment returns on capital not deployed in any segments, returns from investments not allocated to any business segments, transactions with other segments and consolidating adjustments.

Closed Block Business. The Closed Block Business, which is managed separately from the Financial Services Businesses, was established on the date of demutualization. It includes the Closed Block (as discussed in Note 9); 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 11) and certain related assets and liabilities.

Segment Accounting Policies. The accounting policies of the segments are the same as those described in Note 2. Results for each segment include earnings on attributed equity established at a level which management considers necessary to support each segment's risks. Operating expenses specifically identifiable to a particular segment are allocated to that segment as incurred. Operating expenses not identifiable to a specific segment that are incurred in connection with the generation of segment revenues are generally allocated based upon the segment's historical percentage of general and administrative expenses.

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, extraordinary gain on acquisition and cumulative effect of accounting change" as determined in accordance with GAAP but is the measure of segment profit or loss used by the Company to evaluate segment performance and allocate resources, and, consistent with SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," is the measure of segment performance presented below.

Adjusted operating income is calculated by adjusting each segment's "income from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change" to exclude the following items, which are described in greater detail below:

- realized investment gains, net of losses, 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;
- life insurance sales practices remedies and costs; 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 GAAP.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

20. SEGMENT INFORMATION *(continued)*

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

Realized investment gains, net of losses, and related charges and adjustments. Adjusted operating income excludes net realized investment gains and losses. A significant element of realized losses is impairments and losses from sales of credit-impaired securities, the timing of which depends largely on market credit cycles and can vary considerably across periods. The timing of other sales that would result in gains or losses is largely subject to the Company's discretion and influenced by market opportunities. 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, net of losses, 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, reserves for future policy benefits, and payments associated with the market value adjustment features related to certain of the annuity products we sell. 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 for certain investment-type 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 deferred policy acquisition costs represents the portion of this amortization associated with net realized investment gains and losses. 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. These payments mitigate the 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 adjustments features.

Adjustments to realized investment gains, net of losses, 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 for trading purposes, 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 reflects the impact of an intercompany arrangement with Corporate and Other operations pursuant to which the segment's results in certain countries for a particular year, including its interim reporting periods, are translated at fixed currency exchange rates. The fixed rates are determined in connection with a currency hedging program designed to mitigate the risk that unfavorable rate changes will reduce the segment's U.S. dollar equivalent earnings. Pursuant to this program, the Company executes forward sale contracts in 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 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 (losses of \$84 million and \$51 million, and revenues of \$42 million for the years ended December 31, 2004, 2003 and 2002, respectively). As of December 31, 2004 and 2003, the fair value of open contracts used for this purpose was a net liability of \$230 million and \$152 million, respectively.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

20. SEGMENT INFORMATION *(continued)*

The Company utilizes interest and currency swaps 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 \$14 million, \$51 million and \$52 million for the years ended December 31, 2004, 2003 and 2002, respectively, of periodic settlements and yield adjustments of such contracts.

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 applies to the defined benefit guaranteed-cost contracts acquired. The net results of these contracts are recorded in “Commissions and other income,” as a result of the reinsurance arrangement, and such net results include realized investment gains and losses. These realized investment gains and losses are excluded from adjusted operating income as an adjustment to “Realized investment gains (losses), net.” For the year ended December 31, 2004, realized investment gains of \$1 million were excluded.

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 are experience-rated in that investment results associated with these products will ultimately inure to contractholders. The investments supporting the experience-rated products acquired from CIGNA, as well as certain Prudential legacy experience-rated products included in the International Insurance segment, are classified as trading. These trading investments are reflected on the balance sheet as “Trading account assets supporting insurance liabilities, at fair value” and all investment results are reported in “Commissions and other income.” Mortgage loans that support these experience-rated products are carried at unpaid principal, net of unamortized discounts and an allowance for losses.

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 inure to the contractholders.

Life insurance sales practices remedies and costs. Adjusted operating income excludes life insurance sales practices remedies and costs relating to the settlement of individual life insurance sales practices issues for the period from 1982 through 1995 because they related to a substantial and identifiable non-recurring event.

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 GAAP, are excluded from adjusted operating income as the results of divested businesses are not relevant to understanding the Company’s ongoing operating results.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

20. SEGMENT INFORMATION *(continued)*

The summary below reconciles adjusted operating income to income from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change:

	Years Ended December 31,		
	2004	2003	2002
	(in millions)		
Adjusted Operating Income before income taxes for Financial Services Businesses by Segment:			
Individual Life and Annuities	\$ 817	\$ 619	\$ 390
Group Insurance	174	169	155
Total Insurance Division	991	788	545
Asset Management	266	208	184
Financial Advisory	(245)	(111)	(43)
Retirement	334	192	141
Total Investment Division	355	289	282
International Insurance	917	819	757
International Investments	86	(10)	—
Total International Insurance and Investments Division	1,003	809	757
Corporate and Other	158	88	156
Adjusted Operating Income before income taxes for Financial Services Businesses	2,507	1,974	1,740
Items excluded from Adjusted Operating Income:			
Realized investment gains (losses), net, and related adjustments	82	(156)	(872)
Charges related to realized investment gains (losses), net	(58)	(43)	6
Investment gains (losses) on trading account assets supporting insurance liabilities, net	(43)	—	—
Change in experience-rated contractholder liabilities due to asset value changes	(11)	—	—
Sales practices remedies and costs	—	—	(20)
Divested businesses	(105)	(166)	(15)
Income from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change for Financial Services Businesses	2,372	1,609	839
Income (loss) from continuing operations before income taxes for Closed Block Business	915	370	(757)
Income from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change	\$3,287	\$1,979	\$ 82

The Individual Life and Annuities segment results reflect deferred policy acquisition costs as if the individual annuity business were a stand-alone operation. The elimination of intersegment costs capitalized in accordance with this policy is included in consolidating adjustments within Corporate and Other operations.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

20. SEGMENT INFORMATION *(continued)*

The summary below presents certain financial information for the Company's reportable segments:

	Year ended December 31, 2004						
	Revenues	Net Investment Income	Policyholders' Benefits	Interest Credited to Policyholders' Account Balances	Dividends to Policyholders	Interest Expense	Amortization of Deferred Policy Acquisition Costs
	(in millions)						
Financial Services Businesses:							
Individual Life and Annuities	\$ 3,703	\$1,010	\$ 844	\$ 523	\$ 18	\$ 24	\$399
Group Insurance	3,867	561	2,930	185	—	8	4
Total Insurance Division	7,570	1,571	3,774	708	18	32	403
Asset Management	1,464	69	—	—	—	11	43
Financial Advisory	318	2	—	—	—	—	—
Retirement	3,225	2,272	862	1,362	—	37	10
Total Investment Division	5,007	2,343	862	1,362	—	48	53
International Insurance	6,435	908	4,096	117	86	5	365
International Investments	447	30	—	—	—	2	—
Total International Insurance and Investments Division	6,882	938	4,096	117	86	7	365
Corporate and Other	526	532	95	(4)	4	209	(55)
Total	19,985	5,384	8,827	2,183	108	296	766
Items excluded from adjusted operating income:							
Realized investment gains (losses), net, and related adjustments	82	—	—	—	—	—	—
Related charges	(43)	—	3	3	13	—	2
Total realized investment gains (losses), net, and related charges and adjustments	39	—	3	3	13	—	2
Investment gains (losses) on trading account assets supporting insurance liabilities, net	(43)	—	—	—	—	—	—
Change in experience-rated contractholder liabilities due to asset value changes	—	—	—	11	—	—	—
Divested businesses	136	14	10	—	—	—	—
Total Financial Services Businesses	20,117	5,398	8,840	2,197	121	296	768
Closed Block Business	8,231	3,681	4,056	137	2,364	169	105
Total per Consolidated Financial Statements	\$28,348	\$9,079	\$12,896	\$2,334	\$2,485	\$465	\$873

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

20. SEGMENT INFORMATION *(continued)*

	Year ended December 31, 2003						
	Revenues	Net Investment Income	Policyholders' Benefits	Interest Credited to Policyholders' Account Balances (in millions)	Dividends to Policyholders	Interest Expense	Amortization of Deferred Policy Acquisition Costs
Financial Services Businesses:							
Individual Life and Annuities	\$ 3,082	\$ 861	\$ 984	\$ 420	\$ 17	\$ (2)	\$242
Group Insurance	3,690	585	2,797	216	—	2	3
Total Insurance Division	6,772	1,446	3,781	636	17	—	245
Asset Management	1,360	55	—	—	—	16	54
Financial Advisory	1,306	53	—	—	—	—	—
Retirement	2,281	2,043	791	946	—	17	12
Total Investment Division	4,947	2,151	791	946	—	33	66
International Insurance	5,655	787	3,520	109	94	3	284
International Investments	240	4	—	—	—	—	—
Total International Insurance and Investments Division	5,895	791	3,520	109	94	3	284
Corporate and Other	494	547	77	—	4	164	(62)
Total	18,108	4,935	8,169	1,691	115	200	533
Items excluded from adjusted operating income:							
Realized investment gains (losses), net, and related adjustments	(156)	—	—	—	—	—	—
Related charges	—	—	(1)	—	35	—	9
Total realized investment gains (losses), net, and related charges and adjustments	(156)	—	(1)	—	35	—	9
Investment gains (losses) on trading account assets supporting insurance liabilities, net	—	—	—	—	—	—	—
Change in experience-rated contractholder liabilities due to asset value changes	—	—	—	—	—	—	—
Divested businesses	1,954	113	1,082	—	—	—	269
Total Financial Services Businesses	19,906	5,048	9,250	1,691	150	200	811
Closed Block Business	7,982	3,632	4,174	139	2,452	165	121
Total per Consolidated Financial Statements	\$27,888	\$8,680	\$13,424	\$1,830	\$2,602	\$365	\$932

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

20. SEGMENT INFORMATION (continued)

	Year ended December 31, 2002						
	Revenues	Net Investment Income	Policyholders' Benefits	Interest Credited to Policyholders' Account Balances (in millions)	Dividends to Policyholders	Interest Expense	Amortization of Deferred Policy Acquisition Costs
Financial Services Businesses:							
Individual Life and Annuities	\$ 2,696	\$ 837	\$ 815	\$ 398	\$ 16	\$ 1	\$ 500
Group Insurance	3,586	582	2,703	235	—	2	(2)
Total Insurance Division	6,282	1,419	3,518	633	16	3	498
Asset Management	1,325	60	—	—	—	12	72
Financial Advisory	2,421	148	—	—	—	—	—
Retirement	2,375	2,090	880	978	—	18	20
Total Investment Division	6,121	2,298	880	978	—	30	92
International Insurance	5,073	682	3,175	96	103	1	233
International Investments	245	31	—	—	—	—	1
Total International Insurance and Investments Division	5,318	713	3,175	96	103	1	234
Corporate and Other	420	622	98	—	3	161	(85)
Total	18,141	5,052	7,671	1,707	122	195	739
Items excluded from adjusted operating income:							
Realized investment gains (losses), net, and related adjustments	(872)	—	—	—	—	—	—
Related charges	—	—	(1)	—	16	—	(21)
Total realized investment gains (losses), net, and related charges and adjustments	(872)	—	(1)	—	16	—	(21)
Investment gains (losses) on trading account assets supporting insurance liabilities, net	—	—	—	—	—	—	—
Change in experience-rated contractholder liabilities due to asset value changes	—	—	—	—	—	—	—
Divested businesses	1,888	148	1,403	—	—	—	335
Total Financial Services Businesses	19,157	5,200	9,073	1,707	138	195	1,053
Closed Block Business	7,121	3,618	4,305	139	2,506	156	162
Total per Consolidated Financial Statements	\$26,278	\$8,818	\$13,378	\$1,846	\$2,644	\$351	\$1,215

Income from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change includes income from foreign operations of \$913 million, \$659 million and \$332 million for the years ended December 31, 2004, 2003 and 2002, respectively. Revenues, calculated in accordance with GAAP, include revenues from foreign operations of \$7,051 million, \$6,007 million and \$5,112 million for the years ended December 31, 2004, 2003 and 2002, respectively. Included in the revenues from foreign operations are revenues from Japanese operations of \$5,439 million, \$4,703 million and \$4,126 million for the years ended December 31, 2004, 2003 and 2002, respectively.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

20. SEGMENT INFORMATION *(continued)*

The Asset Management segment revenues include intersegment revenues of \$348 million, \$343 million and \$378 million for the years ended December 31, 2004, 2003 and 2002, respectively, primarily consisting of asset-based management and administration fees. In addition, the Financial Advisory segment revenues include intersegment revenues of \$0 million, \$85 million and \$194 million for the years ended December 31, 2004, 2003 and 2002, respectively, relating to the sale of proprietary investments products. Management has determined the intersegment revenues with reference to market rates. Intersegment revenues are eliminated in consolidation.

The summary below presents total assets for the Company's reportable segments at December 31,

	Assets		
	2004	2003	2002
	(in millions)		
Individual Life and Annuities	\$ 84,498	\$ 77,313	\$ 44,482
Group Insurance	24,250	20,898	18,419
Total Insurance Division	108,748	98,211	62,901
Asset Management	24,795	27,124	24,498
Financial Advisory	1,151	2,805	15,525
Retirement	116,596	59,268	56,018
Total Investment Division	142,542	89,197	96,041
International Insurance	57,761	45,989	40,741
International Investments	4,425	3,883	2,332
Total International Insurance and Investments Division	62,186	49,872	43,073
Corporate and Other	16,002	15,258	21,155
Total Financial Services Businesses	329,478	252,538	223,170
Closed Block Business	71,580	68,736	69,446
Total	\$401,058	\$321,274	\$292,616

21. COMMITMENTS AND GUARANTEES, CONTINGENCIES AND LITIGATION AND REGULATORY MATTERS

Commitments and Guarantees

The Company occupies leased office space in many locations under various long-term leases and has entered into numerous leases covering the long-term use of computers and other equipment. Rental expense, net of sub-lease income, incurred for the years ended December 31, 2004, 2003 and 2002 was \$199 million, \$308 million and \$449 million, respectively.

The following table presents, at December 31, 2004, the Company's future commitments on long-term debt, as more fully described in Note 11, and future minimum lease payments under non-cancelable operating leases along with associated sub-lease income:

	Long-term Debt	Operating Leases	Sub-lease Income
	(in millions)		
2005	\$ —	\$ 214	\$ (46)
2006	753	190	(43)
2007	264	166	(41)
2008	1,123	118	(31)
2009	24	95	(27)
Beyond 2009	5,463	264	(37)
Total	\$7,627	\$1,047	\$(225)

PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

21. COMMITMENTS AND GUARANTEES, CONTINGENCIES AND LITIGATION AND REGULATORY MATTERS *(continued)*

For business reasons, the Company exits certain non-cancelable leases prior to their expiration. In these instances, the Company's policy is to accrue the future rental expense and any sub-lease income immediately and release the reserve over the remaining commitment in the year that it is due. Of the \$1,047 million in total non-cancelable operating leases and \$225 million in total sub-lease income, \$237 million and \$178 million, respectively, has already been reserved toward future period rental expenses.

In connection with the Company's commercial mortgage banking business, it originates commercial mortgage loans. At December 31, 2004, the Company had outstanding commercial mortgage loan commitments with borrowers of \$1,350 million. In certain of these transactions, the Company prearranges that it will sell the loan to an investor after the Company funds the loan. As of December 31, 2004, \$494 million of the Company's commitments to originate commercial mortgage loans are subject to such arrangements.

The Company also has other commitments, some of which are contingent upon events or circumstances not under the Company's control, including those at the discretion of the Company's counterparty. These other commitments amounted to \$4,067 million at December 31, 2004. Reflected in these other commitments are \$3,971 million of commitments to purchase or fund investments, including \$2,932 million that the Company anticipates will be funded from the assets of its separate accounts.

In the course of the Company's business, it provides certain guarantees and indemnities to third parties pursuant to which it may be contingently required to make payments now or in the future.

A number of guarantees provided by the Company relate to real estate investments, in which the investor has borrowed funds, and the Company has guaranteed their obligation to their lender. In some cases, the investor is an affiliate, and in other cases the unaffiliated investor purchases the real estate investment from the Company. The Company provides these guarantees to assist them in obtaining financing for the transaction on more beneficial terms. The Company's maximum potential exposure under these guarantees was \$1,315 million at December 31, 2004. Any payments that may become required of the Company under these guarantees would either first be reduced by proceeds received by the creditor on a sale of the assets, or would provide the Company with rights to obtain the assets. These guarantees expire at various times over the next 10 years. At December 31, 2004, no amounts were accrued as a result of the Company's assessment that it is unlikely payments will be required.

Certain contracts underwritten by the Retirement segment's guaranteed products business include guarantees related to financial assets owned by the guaranteed party. These contracts are accounted for as derivatives, at fair value, in accordance with SFAS No. 133. At December 31, 2004, such contracts in force carried a total guaranteed value of \$2,002 million.

The Company's commercial mortgage banking business provides guarantees related to debt instruments owned by the guaranteed party. At December 31, 2004, such arrangements carried a total guaranteed value of \$247 million, with remaining contractual maturities of up to 15 years. The Company anticipates the extinguishment of its obligation under these guarantees prior to maturity as the Company intends to aggregate and pool individual items for transfer to substitute guarantors. These guarantees are secured by rights to properties valued at \$323 million at December 31, 2004. At December 31, 2004, the Company has accrued liabilities of \$7 million representing unearned fees on these guarantees.

As discussed in Note 19, the Company writes credit default swaps requiring payment of principal due in exchange for the referenced credits, depending on the nature or occurrence of specified credit events for the referenced entities. In the event of a specified credit event, the Company's maximum amount at risk, assuming the value of the referenced credits become worthless, is \$628 million at December 31, 2004. The credit default swaps generally have maturities of five years or less.

In connection with certain acquisitions, the Company has agreed to pay additional consideration in future periods, based upon the attainment by the acquired entity of defined operating objectives. In accordance with GAAP, the Company does not accrue contingent consideration obligations prior to the attainment of the objectives. At December 31, 2004, maximum potential future consideration pursuant to such arrangements, to be resolved over the following five years, is \$344 million. Any such payments would result in increases in intangible assets, including goodwill.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

21. COMMITMENTS AND GUARANTEES, CONTINGENCIES AND LITIGATION AND REGULATORY MATTERS *(continued)*

The Company is also subject to other financial guarantees and indemnity arrangements. The Company has provided indemnities and guarantees related to acquisitions, dispositions, investments or other transactions that are triggered by, among other things, breaches of representations, warranties or covenants provided by the Company. These obligations are typically subject to various time limitations, defined by the contract or by operation of law, such as statutes of limitation. In some cases, the maximum potential obligation is subject to contractual limitations, while in other cases such limitations are not specified or applicable. Since certain of these obligations are not subject to limitations, it is not possible to determine the maximum potential amount due under these guarantees. At December 31, 2004, the Company has accrued liabilities of \$13 million associated with all other financial guarantees and indemnity arrangements, which does not include retained liabilities associated with sold businesses.

Contingencies

As discussed in Note 3, in the fourth quarter of 2003, the Company sold its property and casualty insurance companies that operated nationally in 48 states outside of New Jersey, and the District of Columbia, to Liberty Mutual. In connection with that sale, the Company reinsured Liberty Mutual for certain losses including: any adverse loss development on losses occurring prior to the sale that arise from insurance contracts generated through certain “discontinued” distribution channels or due to certain loss events including mold damage or the October 2003 California wild fires; stop-loss protection on losses occurring after the sale and arising from those same distribution channels of up to \$95 million, in excess of related premiums and other adjustments; and stop-loss protection on losses occurring prior to the sale and arising from most other business, up to 75% of the first \$30 million of adverse loss development recorded through October 31, 2005. The reinsurance covering the losses associated with the discontinued distribution channels will be settled based upon loss experience through December 31, 2008, with a provision that profits on the insurance business from these channels will be shared, with Liberty Mutual receiving up to \$20 million of the first \$50 million. In addition, the Company reinsured Liberty Mutual for the remaining \$54 million of potential adverse loss on the stop-loss reinsurance agreement that one of the subsidiaries sold to Liberty Mutual had entered into with the purchaser of the Company’s commercial property and casualty insurer in 2000.

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. 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, 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 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.

In 2004, the Company, along with a number of other insurance companies, received formal requests for information from the New York State Attorney General’s Office, the Securities and Exchange Commission, the Connecticut Attorney General’s Office, the Massachusetts Office of the Attorney General, the Department of Labor 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

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

21. COMMITMENTS AND GUARANTEES, CONTINGENCIES AND LITIGATION AND REGULATORY MATTERS *(continued)*

concerning these and related subjects. The Company is cooperating fully with these inquiries. These matters are the subject of litigation brought by private plaintiffs, including putative class actions and shareholder derivative actions, and the California Department of Insurance and may be the subject of additional regulatory and private actions.

Commencing in 2003, the Company received formal requests for information from regulators and law enforcement authorities relating to the purchase and sale of mutual fund shares and variable annuities. They include, among others, the Securities and Exchange Commission, the New York Stock Exchange, the National Association of Securities Dealers, the New Jersey Bureau of Securities, the State of New York Attorney General's Office, the Securities Division of Massachusetts and the United States Attorney, District of Massachusetts. The matters under investigation principally concern the retail brokerage operations of the former Prudential Securities and the business of certain American Skandia entities.

The Securities Division of Massachusetts filed an administrative complaint in 2003 against Prudential Securities alleging that it knew or should have known about alleged deceptive market timing and late trading in mutual funds in its Boston branch, failed reasonably to supervise the conduct of the brokers in that branch and failed to implement controls designed to prevent and detect violations of Massachusetts securities law. This action remains pending. The Company believes that other pending investigations will likely result in proceedings and/or settlements based on allegations related to market timing similar to those asserted by the Securities Division of Massachusetts. The Company is engaged in ongoing discussions with all relevant parties, including the Securities Division of Massachusetts, and is fully cooperating with them. The Company has established a reserve for anticipated settlement costs, but there are no assurances that this reserve will prove adequate.

In connection with American Skandia, the Company believes that certain of the investigations are likely to lead to proceedings and/or settlements based on allegations concerning market timing in American Skandia products. The Company is engaged in ongoing discussions with the relevant regulators and is fully cooperating with them. Prudential Financial purchased the American Skandia entities in May 2003. Any regulatory settlement involving an American Skandia entity would be subject to the indemnification provisions of the acquisition agreement between Prudential Financial and Skandia Insurance Company Ltd (publ).

In addition to these 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 2000, plaintiffs filed a purported national class action against Prudential Insurance in the District Court of Valencia County, New Mexico, *Azar, et al. v. Prudential Insurance*, based upon the alleged failure to disclose adequately 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 includes allegations that Prudential Insurance should have disclosed to each policyholder who paid for coverage on a modal basis the dollar cost difference between the modal premium and the annual premium required for the policy, as well as the effective annual percentage rate of interest of such difference. Based on these allegations, plaintiffs assert statutory claims including violation of the New Mexico Unfair Practices Act, and common law claims for breach of the implied covenant of good faith and fair dealing, breach of fiduciary duty, unjust enrichment and fraudulent concealment. The complaint seeks injunctive relief, compensatory and punitive damages, both in unspecified amounts, restitution, treble damages, pre-judgment 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 the finding of summary judgment in favor of plaintiffs and dismissed the counts in the complaint for breach of the covenant of good faith and fair dealing and breach of fiduciary duty. The case was remanded to the trial court to determine if the alleged nondisclosures were material to plaintiffs. In November 2004, the trial court issued an order holding that, as to the named plaintiffs, the non-disclosure was material and reliance had been established. Plaintiffs' motion for class certification of a multi-state class is under consideration by the court.

PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

21. COMMITMENTS AND GUARANTEES, CONTINGENCIES AND LITIGATION AND REGULATORY MATTERS (*continued*)

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 seeks 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. In September 2004, the United States Court of Appeals for the Eleventh Circuit affirmed with respect only to the federal RICO claims. The trial is scheduled for September 2005.

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 interest and attorneys fees. Prudential Securities' appeal is pending.

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 other Prudential entities, who 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, constitutes a fraudulent conveyance and that the Company received prepayment of approximately \$100 million. All defendants have moved to dismiss the complaint.

The Company's litigation is subject to many uncertainties, and given its complexity and scope, its outcome cannot be predicted. 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 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, should not have a material adverse effect on the Company's financial position.

PRUDENTIAL FINANCIAL, INC.
Notes to Consolidated Financial Statements

22. QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The unaudited quarterly results of operations for the years ended December 31, 2004 and 2003 are summarized in the table below:

	Three months ended			
	March 31	June 30	September 30	December 31
	(in millions, except per share amounts)			
2004				
Total revenues	\$6,743	\$6,904	\$7,346	\$ 7,355
Total benefits and expenses	6,037	6,221	6,282	6,521
Income from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change	706	683	1,064	834
Net income	401	549	728	578
Basic income from continuing operations before extraordinary gain on acquisition and cumulative effect of accounting change per share—Common Stock(a)	0.74	1.01	1.12	0.65
Diluted income from continuing operations before extraordinary gain on acquisition and cumulative effect of accounting change per share—Common Stock(a)	0.73	0.99	1.10	0.64
Basic net income per share—Common Stock(a)	0.58	1.04	1.11	0.65
Diluted net income per share—Common Stock(a)	0.57	1.02	1.08	0.64
Basic and diluted net income (loss) per share—Class B Stock	46.00	3.50	79.00	120.50
2003				
Total revenues	\$6,781	\$7,298	\$6,688	\$ 7,121
Total benefits and expenses	6,468	7,077	6,112	6,252
Income from continuing operations before income taxes, extraordinary gain on acquisition and cumulative effect of accounting change	313	221	576	869
Net income	196	196	297	575
Basic income from continuing operations before extraordinary gain on acquisition and cumulative effect of accounting change per share—Common Stock(a)	0.41	0.22	0.51	0.97
Diluted income from continuing operations before extraordinary gain on acquisition and cumulative effect of accounting change per share—Common Stock(a)	0.41	0.22	0.50	0.96
Basic net income per share—Common Stock(a)	0.39	0.25	0.44	0.93
Diluted net income per share—Common Stock(a)	0.39	0.25	0.44	0.92
Basic and diluted net income (loss) per share—Class B Stock	(9.50)	30.50	29.00	39.50

(a) Quarterly earnings per share amounts may not add to the full year amounts due to the averaging of shares.

As discussed in Note 2, the Company adopted SOP 03-1 effective January 1, 2004. Results for the first quarter of 2004 include a loss from the cumulative effect of accounting changes, net of taxes, of \$79 million related to the adoption of SOP 03-1. In the fourth quarter of 2004 the Company committed to the sale or exit of its Dryden Wealth Management Business and results for the fourth quarter include a charge of \$53 million for the impairment of goodwill associated with this business.

As discussed in Note 3, on July 1, 2003, the Company completed the combination of its retail securities brokerage and clearing operations, with that of Wachovia, forming a joint venture in which the Company has a 38% ownership interest. The Company accounts for its ownership interest under the equity method of accounting; periods prior to July 1, 2003, continue to reflect the results of the Company's previously wholly-owned securities brokerage operations on a fully consolidated basis. Results for the fourth quarter of 2003 include the gain from the receipt by the Company of a \$332 million settlement of an arbitration award. Results for the second quarter of 2003 include a \$455 million loss related to the disposition of the Company's property and casualty insurance operations discussed in Note 3.

PRUDENTIAL FINANCIAL, INC.

**Supplemental Combining Statements of Financial Position
December 31, 2004 and 2003 (in millions)**

	2004			2003		
	Financial Services Businesses	Closed Block Business	Consolidated	Financial Services Businesses	Closed Block Business	Consolidated
ASSETS						
Fixed maturities:						
Available for sale, at fair value	\$102,155	\$48,813	\$150,968	\$ 84,353	\$44,590	\$128,943
Held to maturity, at amortized cost	2,747	—	2,747	3,068	—	3,068
Trading account assets supporting insurance liabilities, at fair value	12,964	—	12,964	88	—	88
Other trading account assets, at fair value	1,547	—	1,547	3,214	—	3,214
Equity securities, available for sale, at fair value	1,663	2,620	4,283	1,119	2,282	3,401
Commercial loans	17,092	7,297	24,389	12,463	7,006	19,469
Policy loans	2,919	5,454	8,373	2,609	5,543	8,152
Securities purchased under agreements to resell	127	—	127	1,464	—	1,464
Other long-term investments	4,934	1,047	5,981	4,568	1,041	5,609
Short-term investments	3,405	1,840	5,245	4,052	3,581	7,633
Total investments	149,553	67,071	216,624	116,998	64,043	181,041
Cash and cash equivalents	6,164	1,908	8,072	5,791	2,158	7,949
Accrued investment income	1,307	721	2,028	1,046	751	1,797
Reinsurance recoverables	32,790	—	32,790	633	—	633
Deferred policy acquisition costs	7,624	1,223	8,847	6,605	1,221	7,826
Other assets	16,472	657	17,129	14,785	563	15,348
Separate account assets	115,568	—	115,568	106,680	—	106,680
TOTAL ASSETS	\$329,478	\$71,580	\$401,058	\$252,538	\$68,736	\$321,274
LIABILITIES AND ATTRIBUTED EQUITY						
LIABILITIES						
Future policy benefits	\$ 52,794	\$49,511	\$102,305	\$ 46,003	\$48,842	\$ 94,845
Policyholders' account balances	69,668	5,557	75,225	44,168	5,523	49,691
Unpaid claims and claim adjustment expenses	1,807	—	1,807	1,687	—	1,687
Policyholders' dividends	1,132	4,218	5,350	1,077	3,611	4,688
Reinsurance payables	32,386	—	32,386	180	—	180
Securities sold under agreements to repurchase	4,657	4,301	8,958	5,196	4,458	9,654
Cash collateral for loaned securities	4,248	3,021	7,269	3,571	2,215	5,786
Income taxes payable	2,681	—	2,681	2,234	48	2,282
Securities sold but not yet purchased	427	—	427	1,598	—	1,598
Short-term debt	3,896	148	4,044	4,739	—	4,739
Long-term debt	5,877	1,750	7,627	3,860	1,750	5,610
Other liabilities	13,128	1,939	15,067	11,205	1,337	12,542
Separate account liabilities	115,568	—	115,568	106,680	—	106,680
Total liabilities	308,269	70,445	378,714	232,198	67,784	299,982
COMMITMENTS AND CONTINGENCIES						
ATTRIBUTED EQUITY						
Accumulated other comprehensive income	1,817	374	2,191	1,777	669	2,446
Other attributed equity	19,392	761	20,153	18,563	283	18,846
Total attributed equity	21,209	1,135	22,344	20,340	952	21,292
TOTAL LIABILITIES AND ATTRIBUTED EQUITY	\$329,478	\$71,580	\$401,058	\$252,538	\$68,736	\$321,274

See Notes to Supplemental Combining Financial Information

PRUDENTIAL FINANCIAL, INC.
Supplemental Combining Statements of Operations
Years Ended December 31, 2004 and 2003 (in millions)

	2004			2003		
	Financial Services Businesses	Closed Block Business	Consolidated	Financial Services Businesses	Closed Block Business	Consolidated
REVENUES						
Premiums	\$ 8,804	3,776	12,580	\$ 9,373	\$3,860	\$13,233
Policy charges and fee income	2,317	—	2,317	2,001	—	2,001
Net investment income	5,398	3,681	9,079	5,048	3,632	8,680
Realized investment gains (losses), net	11	715	726	(156)	426	270
Commissions and other income	3,587	59	3,646	3,640	64	3,704
Total revenues	<u>20,117</u>	<u>8,231</u>	<u>28,348</u>	<u>19,906</u>	<u>7,982</u>	<u>27,888</u>
BENEFITS AND EXPENSES						
Policyholders' benefits	8,840	4,056	12,896	9,250	4,174	13,424
Interest credited to policyholders' account balances	2,197	137	2,334	1,691	139	1,830
Dividends to policyholders	121	2,364	2,485	150	2,452	2,602
General and administrative expenses	6,587	759	7,346	6,715	847	7,562
Loss on disposition of property and casualty insurance operations ...	—	—	—	491	—	491
Total benefits and expenses	<u>17,745</u>	<u>7,316</u>	<u>25,061</u>	<u>18,297</u>	<u>7,612</u>	<u>25,909</u>
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES, EXTRAORDINARY GAIN ON ACQUISITION AND CUMULATIVE EFFECT OF ACCOUNTING CHANGE						
	<u>2,372</u>	<u>915</u>	<u>3,287</u>	<u>1,609</u>	<u>370</u>	<u>1,979</u>
Total income tax expense	<u>622</u>	<u>333</u>	<u>955</u>	<u>526</u>	<u>131</u>	<u>657</u>
INCOME FROM CONTINUING OPERATIONS BEFORE EXTRAORDINARY GAIN ON ACQUISITION AND CUMULATIVE EFFECT OF ACCOUNTING CHANGE						
	<u>1,750</u>	<u>582</u>	<u>2,332</u>	<u>1,083</u>	<u>239</u>	<u>1,322</u>
Loss from discontinued operations, net of taxes	(18)	—	(18)	(58)	—	(58)
Extraordinary gain on acquisition, net of taxes	21	—	21	—	—	—
Cumulative effect of accounting change, net of taxes	(79)	—	(79)	—	—	—
NET INCOME	<u><u>\$ 1,674</u></u>	<u><u>\$ 582</u></u>	<u><u>\$ 2,256</u></u>	<u><u>\$ 1,025</u></u>	<u><u>\$ 239</u></u>	<u><u>\$ 1,264</u></u>

See Notes to Supplemental Combining Financial Information

PRUDENTIAL FINANCIAL, INC.

Notes to 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 9 to the Consolidated Financial Statements for a description of the Closed Block). It also includes assets held outside the Closed Block necessary to meet insurance regulatory capital requirements related to products included within the Closed Block; deferred policy acquisition costs related to the Closed Block policies; the principal amount of the IHC debt (as discussed below and in Note 11 to the Consolidated Financial Statements) and related unamortized debt issuance costs and 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 each 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 based on the historical general and administrative expenses of each business as a percentage of the total for the Company.

PHLLC has outstanding IHC debt, of which net proceeds of \$1.66 billion were allocated to the Financial Services Businesses concurrent with the demutualization on December 18, 2001. The IHC debt is serviced by the cash flows of the Closed Block Business, and the results of the Closed Block Business reflect interest expense associated with the IHC debt.

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

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

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

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

MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Prudential Financial's Common Stock was issued to eligible policyholders in Prudential Insurance's demutualization and sold to investors in Prudential Financial's initial public offering. The Common Stock began trading on the New York Stock Exchange under the symbol "PRU" on December 13, 2001. The following table presents the high and low closing prices for the Common Stock on the New York Stock Exchange during the periods indicated and the dividends declared per share during such periods:

	<u>High</u>	<u>Low</u>	<u>Dividends</u>
2004:			
Fourth Quarter	\$55.09	\$42.87	\$0.625
Third Quarter	48.10	44.30	—
Second Quarter	46.47	41.05	—
First Quarter	48.11	41.62	—
2003:			
Fourth Quarter	\$42.19	\$36.60	\$0.500
Third Quarter	38.06	34.00	—
Second Quarter	34.50	29.84	—
First Quarter	33.93	27.56	—

On February 28, 2005, there were 2,806,114 registered holders of record for the Common Stock and 524 million shares outstanding. The closing price of the Common Stock on the New York Stock Exchange on February 28, 2005, was \$57.00.

The Class B Stock was issued to institutional investors (two subsidiaries of American International Group, Inc. and Pacific Life Corp.) in a private placement pursuant to Section 4(2) of the Securities Act of 1933 on the date of demutualization. There is no established public trading market for the Class B Stock. During the fourth quarter of 2003 and 2004, Prudential Financial paid an annual dividend of \$9.625 per share of Class B Stock. On February 28, 2005, there were three holders of record for the Class B Stock and 2.0 million shares outstanding.

Prudential Financial's Board of Directors currently intends to continue to declare and pay annual dividends on the Common Stock and Class B Stock. Future dividend decisions will be based on, and affected by, a number of factors including the financial performance of the Financial Services Businesses and Closed Block Business; our overall financial condition, results of operations, cash requirements and future prospects; regulatory restrictions on the payment of dividends by Prudential Financial's subsidiaries; and such other factors as the Board of Directors may deem relevant. Dividends payable by Prudential Financial are limited to the amount that would be legally available for payment under New Jersey corporate law. For additional information on dividends and related regulatory restrictions, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources" and Note 13 to the Consolidated Financial Statements included in this Annual Report.

On the date of demutualization, Prudential Financial and Prudential Financial Capital Trust I, or the Trust, a statutory business trust, co-issued 13.8 million 6.75% equity security units, or the Units. Each Unit had a stated amount of \$50 and initially consisted of a purchase contract (requiring the holder to purchase shares of Prudential Financial's Common Stock in November 2004, at a price determined by a formula described in the contract) and a redeemable capital security of the Trust with a stated liquidation amount of \$50. Prudential Financial settled the purchase contracts associated with the Units in November 2004. Each purchase contract was settled for 1.47 shares of Prudential Financial's Common Stock resulting in the issuance of 20.3 million shares of Common Stock. Prudential Financial received \$690 million in proceeds from the issuance, to be used for general corporate purposes.

FORWARD-LOOKING STATEMENTS

Some of the statements included in this Annual Report, including but not limited to those in Management's Discussion and Analysis of Financial Condition and Results of Operations, may 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," "intends," "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 of financial markets and interest rate fluctuations; (2) domestic or international military or terrorist activities or conflicts; (3) volatility in the securities markets; (4) fluctuations in foreign currency exchange rates and foreign securities markets; (5) regulatory or legislative changes, including changes in tax law; (6) changes in statutory or U.S. GAAP accounting principles, practices or policies; (7) differences between actual experience regarding mortality, morbidity, persistency, surrender experience, interest rates, or market returns and the assumptions we use in pricing our products, establishing liabilities and reserves or for other purposes; (8) reestimates of our reserves for future policy benefits and claims; (9) changes in our assumptions related to deferred policy acquisition costs; (10) events resulting in catastrophic loss of life; (11) investment losses and defaults; (12) changes in our claims-paying or credit ratings; (13) competition in our product lines and for personnel; (14) economic, political, currency and other risks relating to our international operations; (15) Prudential Financial, Inc.'s primary reliance, as a holding company, on dividends or distributions from its subsidiaries to meet debt payment obligations and the applicable regulatory restrictions on the ability of the subsidiaries to pay such dividends or distributions; (16) risks due to the lack of legal separation between our Financial Services Businesses and our Closed Block Business; (17) adverse determinations in litigation or regulatory matters and our exposure to contingent liabilities; and (18) the effects of acquisitions, divestitures and restructurings, including possible difficulties in integrating and realizing the projected results of acquisitions. Prudential Financial, Inc. does not intend, and is under no obligation, to update any particular forward-looking statement included in this Annual Report.

SEC AND NYSE CERTIFICATIONS

The certifications by the Chief Executive Officer and the Chief Financial Officer of Prudential Financial, Inc. required under Section 302 of the Sarbanes-Oxley Act of 2002 have been filed as exhibits to Prudential Financial's 2004 Annual Report on Form 10-K. In addition, the Chief Executive Officer of Prudential Financial made an unqualified certification to the New York Stock Exchange (NYSE) regarding Prudential Financial's compliance with the NYSE corporate governance listing standards in June 2004.

Shareholder Information

Corporate Office

Prudential Financial, Inc.
751 Broad Street, Newark, NJ 07102
973-802-6000

Stock Exchange Listing

The Common Stock of Prudential Financial, Inc. is traded on the New York Stock Exchange under the symbol "PRU."

Shareholder Services at EquiServe

EquiServe Trust Company, N.A., the transfer agent for Prudential Financial, Inc., can assist registered shareholders with a variety of services, including:

- Change of address
- Transfer of stock
- Direct deposit of dividends

For more information, contact EquiServe directly:

Online: www.prudential.equiserve.com

By phone:

- Within the United States at
800-305-9404
- Outside the United States at
732-512-3782
- For the hearing-impaired, TDD/TDY is available at
800-619-2837

Customer service representatives are available Monday to Friday from 8:30 a.m. to 6:00 p.m. (ET). An Interactive Voice Response System is available 24 hours a day, 7 days a week.

By Mail:

EquiServe Trust Company, N.A.
P.O. Box 43033, Providence, RI 02940-3033

Request Online Delivery of Annual Reports and Proxy Statements

You can decrease the amount of mail sent to your home, and help Prudential Financial, Inc. reduce its printing and mailing costs, by viewing proxy statements, annual reports and related materials online. To request online receipt of these materials, visit www.icsdelivery.com/prudential and follow the enrollment instructions.

Annual Meeting

Shareholders are invited to attend Prudential Financial, Inc.'s annual meeting, which will be held on June 7, 2005, beginning at 2 p.m. at our corporate headquarters. The meeting will be broadcast live via the Investor Relations website, www.investor.prudential.com. Additional information about the meeting can be found in the proxy statement.

Information about Prudential Financial, Inc.

You can contact Prudential Financial's Corporate Information Service at 877-998-7625 at any time to obtain or listen to financial results or press releases, or to hear answers to frequently asked questions. **In addition, you may request a copy of our Annual Report on Form 10-K, which we will send to you without charge.** You may also access our press releases, financial information and reports filed with the Securities and Exchange Commission (for example, our Annual Report on Form 10-K, our Quarterly Reports on Form 10-Q, and our Current Reports on Form 8-K and any amendments to those forms) online at **www.investor.prudential.com**. Copies of any of our documents on our website are available without charge, and reports filed with or furnished to the Securities and Exchange Commission will be available as soon as reasonably practicable after they are filed with or furnished to the Commission.

Investor Relations

Institutional investors, analysts and other members of the professional financial community can contact our Investor Relations department via e-mail at investor.relations@prudential.com, or by visiting the Investor Relations website at www.investor.prudential.com.

Visit the Prudential Financial, Inc. Website

For more information on our company, including our products and services, visit the Prudential Financial, Inc. website at www.prudential.com.



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