PRUDENTIAL FINANCIAL INC
Form 10-K/A
February 15, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

AMENDMENT NO. 1

(MARK ONE)

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

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2004

OR

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

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER 001-16707

Prudential Financial, Inc.

(Exact Name of Registrant as Specified in its Charter)

New Jersey	**22-3703799**

(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification Number)**

751 Broad Street

Newark, New Jersey 07102

(973) 802-6000

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

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, Par Value $.01 (including Shareholder Protection Rights)	New York Stock Exchange

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT: NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Exchange Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

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

As of June 30, 2004, the aggregate market value of the registrant s Common Stock (par value $0.01) held by non-affiliates of the registrant was $24.21 billion and 521 million shares of the Common Stock were outstanding. As of February 28, 2005, 524 million shares of the registrant s Common Stock (par value $0.01) were outstanding. As of June 30, 2004, and February 28, 2005, 2 million shares of the registrant s Class B Stock, for which there is no established public trading market, were outstanding and held by non-affiliates of the registrant.

DOCUMENTS INCORPORATED BY REFERENCE

THE INFORMATION REQUIRED TO BE FURNISHED PURSUANT TO PART III OF THIS FORM 10-K IS SET FORTH IN, AND IS HEREBY INCORPORATED BY REFERENCE HEREIN FROM, THE REGISTRANT S DEFINITIVE PROXY STATEMENT FOR THE ANNUAL MEETING OF SHAREHOLDERS TO BE HELD ON JUNE 7, 2005, TO BE FILED BY THE REGISTRANT WITH THE SECURITIES AND EXCHANGE COMMISSION PURSUANT TO REGULATION 14A NOT LATER THAN 120 DAYS AFTER THE YEAR ENDED DECEMBER 31, 2004.

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EXPLANATORY NOTE

This Amendment No. 1 on Form 10-K/A is being filed for the purpose of amending Items 8 and 9A of Part II of the Annual Report on Form 10-K for the year ended December 31, 2004 of Prudential Financial, Inc. (Prudential Financial) to reflect the restatement of Prudential Financial s Consolidated Statements of Cash Flows for the years ended December 31, 2004, 2003 and 2002, as described in Footnote 2 to the Consolidated Financial Statements included in this Form 10-K/A. All other Items of the original filing on Form 10-K made on March 9, 2005 are unaffected by the changes to the Consolidated Statements of Cash Flows and such Items have not been included in this Amendment. Information in this Form 10-K/A is generally stated as of December 31, 2004 and does not reflect any subsequent information or events other than the restatement of the Consolidated Statements of Cash Flows. More current information with respect to Prudential Financial is contained within its Quarterly Report on Form 10-Q for the quarter ended September 30, 2005, and other filings with the Securities and Exchange Commission.

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

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PART II

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

CONSOLIDATED FINANCIAL STATEMENTS

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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

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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 and financial statement schedules

In our opinion, the consolidated financial statements, appearing under Item 8, 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. In addition, in our opinion, the financial statement schedules listed in the index appearing under Item 15(a)(2) present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedules are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and financial statement schedules 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 discussed 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.

As discussed in Note 2 to the consolidated financial statements, the Company has restated its 2004, 2003, and 2002 consolidated financial statements.

Internal control over financial reporting

Also, in our opinion, management s assessment, included in Management s Annual Report on Internal Control Over Financial Reporting, appearing under Item 8, 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

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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.

/s/ PricewaterhouseCoopers LLP

New York, New York

March 8, 2005, except with respect to our opinion on the Consolidated Financial Statements insofar as it relates to Note 2 as to which the date is February 15, 2006.

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PRUDENTIAL FINANCIAL, INC.

Consolidated Statements of Financial Position

December 31, 2004 and 2003 (in millions, except share amounts)

	2004	2003
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	$ 401,058	$ 321,274
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	$ 401,058	$ 321,274

See Notes to Consolidated Financial Statements

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PRUDENTIAL FINANCIAL, INC.

Consolidated Statements of Operations

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

	2004	2003	2002
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	28,348	27,888	26,278
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	25,061	25,909	26,196
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES, EXTRAORDINARY GAIN ON ACQUISITION AND CUMULATIVE EFFECT OF ACCOUNTING CHANGE	3,287	1,979	82
Income taxes:			
Current	601	169	(90)
Deferred	354	488	(98)
Total 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	$ 2,256	$ 1,264	$ 194
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	$ 3.38	$ 1.99	$ 1.25
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	$ 3.31	$ 1.98	$ 1.25
Dividends declared per share of Common Stock	$ 0.625	$ 0.50	$ 0.40
Closed Block Business			
Net income (loss) per share of Class B Stock basic and diluted	$ 249.00	$ 89.50	$ (264.00)
Dividends declared per share of Class B Stock	$ 9.625	$ 9.625	$ 9.625

See Notes to Consolidated Financial Statements

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PRUDENTIAL FINANCIAL, INC.

Consolidated Statements of Stockholders Equity

Years Ended December 31, 2004, 2003 and 2002 (in millions)

	Common Stock								
	Shares	**Amount**	**Class B Stock**	**Additional Paid-in Capital**	**Retained Earnings (Deficit)**	**Common Stock Held in Treasury**	**Deferred Compensation**	**Accumulated Other Comprehensive Income (Loss)**	**Total Stockholders Equity**
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	527.3	$ 6	$	$ 20,354	$ 2,851	$ (2,967)	$ (91)	$ 2,191	$ 22,344

See Notes to Consolidated Financial Statements

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PRUDENTIAL FINANCIAL, INC.

Consolidated Statements of Cash Flows

Years Ended December 31, 2004, 2003 and 2002 (in millions)

	2004 (Restated)	2003 (Restated)	2002 (Restated)
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	(822)	(528)	(563)
Interest credited to policyholders account balances	2,359	1,857	1,846
Depreciation and amortization, including premiums and discounts	537	716	580
Net loss on business dispositions		510	
Change in:			
Deferred policy acquisition costs	(665)	(606)	(211)
Future policy benefits and other insurance liabilities	2,291	2,088	1,975
Trading account assets supporting insurance liabilities and other trading account assets	(1,794)	(2,342)	(1,277)
Income taxes payable	470	263	(205)
Securities sold but not yet purchased	485	1,373	1,442
Other, net	192	(2,919)	(2,628)
Cash flows from operating activities	4,583	1,406	2,518
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from the sale/maturity/prepayment of:			
Fixed maturities, available for sale	70,173	46,905	58,750
Fixed maturities, held to maturity	610	1,418	418
Equity securities, available for sale	2,262	1,412	2,050
Commercial loans	5,663	3,206	3,682
Other long-term investments	1,530	1,146	1,019
Short-term investments	22,154	20,132	15,434
Payments for the purchase of:			
Fixed maturities, available for sale	(80,896)	(50,433)	(67,482)
Fixed maturities, held to maturity	(211)	(1,816)	(2,701)
Equity securities, available for sale	(2,498)	(1,394)	(2,830)
Commercial loans	(4,263)	(2,762)	(2,747)
Other long-term investments	(1,081)	(1,185)	(1,590)
Short-term investments	(18,789)	(22,646)	(16,050)
Acquisition of subsidiaries, net of cash acquired.	(1,082)	(1,109)	
Cash of operations contributed to Wachovia Securities Financial Holdings, LLC		(229)	
Proceeds from sale of subsidiaries, net of cash disposed	(76)	91	
Net change in policy loans	306	1,070	(230)
Cash flows used in investing activities	(6,198)	(6,194)	(12,277)
CASH FLOWS FROM FINANCING ACTIVITIES			
Policyholders account deposits	14,627	10,235	9,148
Policyholders account withdrawals	(14,584)	(9,471)	(7,511)
Net change in securities sold under agreements to repurchase and cash collateral for loaned securities	2,064	(124)	6,079
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 financing arrangements (maturities 90 days or less)	(419)	3,603	(1,666)
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)	4,212	3,607	1,536
Repayments of debt (maturities longer than 90 days)	(2,652)	(3,380)	(2,570)
Cash payments to or in respect of eligible policyholders	(327)	(147)	(2,569)
Other, net	(77)	(438)	(61)
Cash flows from (used in) financing activities	1,807	2,656	1,469
Effect of foreign exchange rate changes on cash balances	(69)	183	(348)
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

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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

Restatement of Consolidated Statements of Cash Flows

The Consolidated Statements of Cash Flows for the years ended December 31, 2004, 2003 and 2002 have been restated to reflect the following:

1. Changes in the net receivable/payable from unsettled investment purchases and sales, previously classified within adjustments to reconcile net income to cash provided by operating activities, have been reclassified to cash flows from investing activities, to the extent such balances pertained to investments classified as either available for sale or held to maturity.

2. The deconsolidations of three previously consolidated subsidiaries are now reported as having no impact to cash flows from operating activities or cash flows from (used in) financing activities. Previously, the deconsolidations were reflected in the Consolidated Statements of Cash Flows as adjustments to cash flows of operating activities and cash flows of financing activities.

3. The net change in the policy loans receivable, previously reported in cash flows from operating activities, is now reported as a component of cash flows of investing activities.

4. Changes in the presentation of bank overdrafts, certain commercial loans, proprietary investments, certain variable product investments, and various other items.

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As a result of the restatements, previously reported cash flows from operating activities, cash flows used in investing activities and cash flows from (used in) financing activities were increased or reduced for the years ended December 31, 2004, 2003 and 2002 as follows:

	Year-Ended December 31,		
	2004	2003	2002
Cash flows from operating activities:			
As originally reported	$ 7,119	$ 784	$ 6,884
Impact of restatements	(2,536)	622	(4,366)
Revised for restatements	$ 4,583	$ 1,406	$ 2,518
Cash flows used in investing activities:			
As originally reported	$ (7,423)	$ (4,401)	$ (14,361)
Impact of restatements	1,225	(1,793)	2,084
Revised for restatements	$ (6,198)	$ (6,194)	$ (12,277)
Cash flows from (used in) financing activities:			
As originally reported	$ 506	$ 1,511	$ (794)
Impact of restatements	1,301	1,145	2,263
Revised for restatements	$ 1,807	$ 2,656	$ 1,469

The restatements had no impact on the total change in cash and cash equivalents within the Consolidated Statements of Cash Flows or on the Consolidated Statements of Operations or Consolidated Statements of Financial Position.

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.

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PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

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

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 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)	$ 1,648	$ 581	$ 990	$ 238	$ 649	$ (485)

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

PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

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

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 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

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PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

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

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.

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

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PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

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

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 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

PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

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

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.

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.

PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

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

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.

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

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PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

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

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.

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

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PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

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

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 thse 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.

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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.

PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

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

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

When a derivative is designated as a cash flow hedge and is determined to be highly effective, changes in its fair value are recorded in Accumulated other comprehensive income (loss) until earnings are affected by the variability of cash flows being hedged (*e.g*., when periodic settlements on a variable-rate asset or liability are 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.

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PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

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

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 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

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PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

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

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 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.

PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

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

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 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.

PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

3. ACQUISITIONS AND DISPOSITIONS *(continued)*

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.

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

PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

3. ACQUISITIONS AND DISPOSITIONS *(continued)*

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	53,727
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	(51,604)
Net assets acquired	$ 2,123

(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.

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.

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PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

3. ACQUISITIONS AND DISPOSITIONS ***(continued)***

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 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.

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PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

3. ACQUISITIONS AND DISPOSITIONS *(continued)*

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)	$ 1,184

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	22,311
Total assets acquired	23,868
Policyholders account balances	(168)

Other liabilities at fair value		(205)
Separate account liabilities		(22,311)
Total liabilities assumed		(22,684)
Net assets acquired(c)	$	1,184

(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.

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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.

PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

3. ACQUISITIONS AND DISPOSITIONS *(continued)*

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

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:

	2004	2003	2002
		(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	$ (18)	$ (58)	$ (76)

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.

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PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

3. ACQUISITIONS AND DISPOSITIONS *(continued)*

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.

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	$ 143,156	$ 8,378	$ 566	$ 150,968
Equity securities, available for sale	$ 3,589	$ 776	$ 82	$ 4,283

	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	$ 2,747	$ 39	$ 21	$ 2,765

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	$ 121,193	$ 8,217	$ 467	$ 128,943
Equity securities, available for sale	$ 2,799	$ 691	$ 89	$ 3,401

	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	$ 3,068	$ 42	$ 26	$ 3,084

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	$ 143,156	$ 150,968	$ 2,747	$ 2,765

Actual maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

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PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

4. INVESTMENTS *(continued)*

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)

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	$ 13,004	$ 12,964	$ 89	$ 88

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.

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PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

4. INVESTMENTS *(continued)*

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	22,395		17,641	
Uncollateralized loans				
Uncollateralized loans	2,329		2,160	
Valuation allowance	(335)		(332)	
Total uncollateralized loans	1,994		1,828	
Net carrying value	$ 24,389		$ 19,469	

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:

	2004	2003	2002
		(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	$ 494	$ 492	$ 496

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:

	2004	2003
	(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	$ 197	$ 171

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

PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

4. INVESTMENTS *(continued)*

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:

	2004	2003
	(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	$ 5,981	$ 5,609

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

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PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

4. INVESTMENTS *(continued)*

	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

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	$ 726	$ 270	$ (1,365)

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PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

4. INVESTMENTS *(continued)*

Net Unrealized Investment Gains (Losses)

Net unrealized investment gains and losses on securities classified as available for sale and certain other long-term investments 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)
				(837)	301	(536)

Impact of net unrealized investment (gains) losses on policyholders dividends						
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	$ 8,365	$ (372)	$ (1,794)	$ (3,141)	$ (1,037)	$ 2,021

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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,

	2004	2003	2002
		(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	$ 8,365	$ 8,242	$ 7,446

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	$ 3
Obligations of U.S. states and their political subdivisions	394	1	86	2	480	3
Foreign government bonds	2,852	37	1,355	113	4,207	150
Corporate securities	14,079	230	2,017	172	16,096	402
Mortgage-backed securities	2,503	15	621	14	3,124	29

Total	$ 20,599	$ 286	$ 4,083	$ 301	$ 24,682	$ 587

(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	$ 34
Obligations of U.S. states and their political subdivisions	235	8	3		238	8
Foreign government bonds	2,703	91	54	2	2,757	93
Corporate securities	8,802	250	1,498	79	10,300	329
Mortgage-backed securities	2,309	29			2,309	29
Total	$ 15,691	$ 412	$ 1,555	$ 81	$ 17,246	$ 493

(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.

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Notes to Consolidated Financial Statements

4. INVESTMENTS *(continued)*

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 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	$ 16	$ 801	$ 82

	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	$ 24	$ 671	$ 89

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.

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PRUDENTIAL FINANCIAL, INC.

Notes to Consolidated Financial Statements

4. INVESTMENTS *(continued)*

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	$ 2	$ 12	$ 2

	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	$ 8	$ 20	$ 8

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:

	2004	2003
	(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	$ 19,844	$ 18,660

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

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Notes to Consolidated Financial Statements

4. INVESTMENTS *(continued)*

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:

	2004	2003	2002
		(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	$ 8,847	$ 7,826	$ 7,031

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:

2004	2003

	(in millions)	
Balance, beginning of year	$ 489	$ 117
Acquisitions	713	440
Amortization(1)	(93)	(90)
Interest(2)	41	17
Foreign currency translation		