

PRUDENTIAL FINANCIAL INC

Form 10-Q

August 03, 2018

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2018

OR

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

For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 001-16707

Prudential Financial, Inc.

(Exact Name of Registrant as Specified in its Charter)

New Jersey 22-3703799

(State or Other Jurisdiction of (I.R.S. Employer

Incorporation or Organization) Identification Number)

751 Broad Street

Newark, New Jersey 07102

(973) 802-6000

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of the Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company)  
Smaller reporting company   
Emerging growth company

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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of July 31, 2018, 417 million shares of the registrant's Common Stock (par value \$0.01) were outstanding.

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Forward-Looking Statements

Certain of the statements included in this Quarterly Report on Form 10-Q constitute forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. Words such as “expects,” “believes,” “anticipates,” “includes,” “plans,” “assumes,” “estimates,” “projects,” “intends,” “should,” “will,” “shall” or variations of such generally part of forward-looking statements. Forward-looking statements are made based on management’s current expectations and beliefs concerning future developments and their potential effects upon Prudential Financial, Inc. and its subsidiaries. There can be no assurance that future developments affecting Prudential Financial, Inc. and its subsidiaries will be those anticipated by management. These forward-looking statements are not a guarantee of future performance and involve risks and uncertainties, and there are certain important factors that could cause actual results to differ, possibly materially, from expectations or estimates reflected in such forward-looking statements, including, among others: (1) losses on investments or financial contracts due to deterioration in credit quality or value, or counterparty default; (2) losses on insurance products due to mortality experience, morbidity experience or policyholder behavior experience that differs significantly from our expectations when we price our products; (3) changes in interest rates, equity prices and foreign currency exchange rates that may (a) adversely impact the profitability of our products, the value of separate accounts supporting these products or the value of assets we manage, (b) result in losses on derivatives we use to hedge risk or increase collateral posting requirements and (c) limit opportunities to invest at appropriate returns; (4) guarantees within certain of our products, in particular our variable annuities, which are market sensitive and may decrease our earnings or increase the volatility of our results of operations or financial position; (5) liquidity needs resulting from (a) derivative collateral market exposure, (b) asset/liability mismatches, (c) the lack of available funding in the financial markets or (d) unexpected cash demands due to severe mortality calamity or lapse events; (6) financial or customer losses, or regulatory and legal actions, due to inadequate or failed processes or systems, human error or misconduct, and external events, such as (a) disruption of our systems and data, (b) an information security breach, (c) a failure to protect the privacy of sensitive data or (d) reliance on third-parties, including to distribute our products; (7) changes in the regulatory landscape, including related to (a) regulation under the Dodd-Frank Wall Street Reform and Consumer Protection Act, (b) changes in tax laws, (c) fiduciary rule developments, (d) U.S. state insurance laws and developments regarding group-wide supervision, capital and reserves, (e) insurer capital standards outside the U.S. and (f) privacy and cybersecurity regulation; (8) technological changes which may adversely impact companies in our investment portfolio or cause insurance experience to deviate from our assumptions; (9) ratings downgrades; (10) market conditions that may adversely affect the sales or persistency of our products; (11) competition; and (12) reputational damage. Prudential Financial, Inc. does not undertake to update any particular forward-looking statement included in this document. See “Risk Factors” included in the Annual Report on Form 10-K for the year ended December 31, 2017 for discussion of certain risks relating to our businesses and investment in our securities.

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## PART I - FINANCIAL INFORMATION

## ITEM 1. Financial Statements

## PRUDENTIAL FINANCIAL, INC.

## Unaudited Interim Consolidated Statements of Financial Position

June 30, 2018 and December 31, 2017 (in millions, except share amounts)

	June 30, 2018	December 31, 2017
<b>ASSETS</b>		
Fixed maturities, available-for-sale, at fair value (amortized cost: 2018-\$317,548; 2017-\$312,385)(1)	\$ 341,151	\$ 346,780
Fixed maturities, held-to-maturity, at amortized cost (fair value: 2018-\$2,388; 2017-\$2,430)(1)	2,020	2,049
Fixed maturities, trading, at fair value (amortized cost: 2018-\$2,980; 2017-\$3,509)(1)(2)	2,916	3,507
Assets supporting experience-rated contractholder liabilities, at fair value(1)(2)	21,497	22,097
Equity securities, at fair value (cost: 2018-\$5,374; 2017-\$5,154)(1)(2)	7,191	7,329
Commercial mortgage and other loans (includes \$330 and \$593 measured at fair value under the fair value option at June 30, 2018 and December 31, 2017, respectively)(1)	58,622	56,045
Policy loans	11,935	11,891
Other invested assets (includes \$5,138 and \$3,159 measured at fair value at June 30, 2018 and December 31, 2017, respectively)(1)(2)	13,459	13,373
Short-term investments(2)	5,728	6,800
Total investments	464,519	469,871
Cash and cash equivalents(1)	14,918	14,490
Accrued investment income(1)	3,235	3,325
Deferred policy acquisition costs	19,643	18,992
Value of business acquired	2,027	1,591
Other assets(1)	16,860	17,250
Separate account assets	298,658	306,617
<b>TOTAL ASSETS</b>	<b>\$ 819,860</b>	<b>\$ 832,136</b>
<b>LIABILITIES AND EQUITY</b>		
<b>LIABILITIES</b>		
Future policy benefits	\$ 260,435	\$ 257,317
Policyholders' account balances	149,359	148,189
Policyholders' dividends	4,858	6,411
Securities sold under agreements to repurchase	9,540	8,400
Cash collateral for loaned securities	4,307	4,354
Income taxes	7,888	9,648
Short-term debt	2,056	1,380
Long-term debt	16,732	17,172
Other liabilities(1)	16,498	16,619
Notes issued by consolidated variable interest entities (includes \$609 and \$1,196 measured at fair value under the fair value option at June 30, 2018 and December 31, 2017, respectively)(1)	937	1,518
Separate account liabilities	298,658	306,617
Total liabilities	771,268	777,625
<b>COMMITMENTS AND CONTINGENT LIABILITIES (See Note 14)</b>		
<b>EQUITY</b>		
Preferred Stock (\$.01 par value; 10,000,000 shares authorized; none issued)	0	0

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Common Stock (\$.01 par value; 1,500,000,000 shares authorized; 660,111,339 shares issued at both June 30, 2018 and December 31, 2017)	6	6
Additional paid-in capital	24,763	24,769
Common Stock held in treasury, at cost (242,400,008 and 230,537,166 shares at June 30, 2018 and December 31, 2017, respectively)	(16,905 )	(16,284 )
Accumulated other comprehensive income (loss)	11,655	17,074
Retained earnings	28,713	28,671
Total Prudential Financial, Inc. equity	48,232	54,236
Noncontrolling interests	360	275
Total equity	48,592	54,511
TOTAL LIABILITIES AND EQUITY	\$ 819,860	\$ 832,136

(1) See Note 4 for details of balances associated with variable interest entities.

(2) Prior period amounts have been reclassified to conform to current period presentation. See "Adoption of ASU 2016-01" in Note 2 for details.

See Notes to Unaudited Interim Consolidated Financial Statements

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## PRUDENTIAL FINANCIAL, INC.

## Unaudited Interim Consolidated Statements of Operations

Three and Six Months Ended June 30, 2018 and 2017 (in millions, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
<b>REVENUES</b>				
Premiums	\$7,438	\$8,326	\$14,749	\$14,807
Policy charges and fee income	1,480	725	2,984	2,258
Net investment income	4,096	4,089	8,094	8,150
Asset management and service fees	1,010	973	2,036	1,924
Other income (loss)	(54 )	420	(561 )	637
Realized investment gains (losses), net:				
Other-than-temporary impairments on fixed maturity securities	(58 )	(53 )	(97 )	(110 )
Other-than-temporary impairments on fixed maturity securities transferred to Other comprehensive income	0	7	0	10
Other realized investment gains (losses), net	743	(1,046 )	1,207	(565 )
Total realized investment gains (losses), net	685	(1,092 )	1,110	(665 )
Total revenues	14,655	13,441	28,412	27,111
<b>BENEFITS AND EXPENSES</b>				
Policyholders' benefits	9,512	8,328	17,187	15,353
Interest credited to policyholders' account balances	894	947	1,444	1,887
Dividends to policyholders	540	491	868	1,106
Amortization of deferred policy acquisition costs	613	84	1,201	523
General and administrative expenses	2,846	2,983	5,769	5,892
Total benefits and expenses	14,405	12,833	26,469	24,761
<b>INCOME (LOSS) BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES</b>	250	608	1,943	2,350
Total income tax expense (benefit)	68	125	420	520
<b>INCOME (LOSS) BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES</b>	182	483	1,523	1,830
Equity in earnings of operating joint ventures, net of taxes	18	13	41	38
<b>NET INCOME (LOSS)</b>	200	496	1,564	1,868
Less: Income (loss) attributable to noncontrolling interests	3	5	4	8
<b>NET INCOME (LOSS) ATTRIBUTABLE TO PRUDENTIAL FINANCIAL, INC.</b>	\$ 197	\$ 491	\$ 1,560	\$ 1,860
<b>EARNINGS PER SHARE</b>				
Basic earnings per share-Common Stock:				
Net income (loss) attributable to Prudential Financial, Inc.	\$0.46	\$1.13	\$3.66	\$4.28
Diluted earnings per share-Common Stock:				
Net income (loss) attributable to Prudential Financial, Inc.	\$0.46	\$1.12	\$3.62	\$4.21
Dividends declared per share of Common Stock	\$0.90	\$0.75	\$1.80	\$1.50

See Notes to Unaudited Interim Consolidated Financial Statements

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## PRUDENTIAL FINANCIAL, INC.

Unaudited Interim Consolidated Statements of Comprehensive Income  
 Three and Six Months Ended June 30, 2018 and 2017 (in millions)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
NET INCOME (LOSS)	\$200	\$496	\$1,564	\$1,868
Other comprehensive income (loss), before tax:				
Foreign currency translation adjustments for the period	(703 )	45	(41 )	597
Net unrealized investment gains (losses)	(3,326 )	2,491	(7,992 )	1,682
Defined benefit pension and postretirement unrecognized periodic benefit (cost)	75	55	129	99
Total	(3,954 )	2,591	(7,904 )	2,378
Less: Income tax expense (benefit) related to other comprehensive income (loss)	(838 )	872	(1,682 )	656
Other comprehensive income (loss), net of taxes	(3,116 )	1,719	(6,222 )	1,722
Comprehensive income (loss)	(2,916 )	2,215	(4,658 )	3,590
Less: Comprehensive income (loss) attributable to noncontrolling interests	(7 )	5	7	(11 )
Comprehensive income (loss) attributable to Prudential Financial, Inc.	\$(2,909)	\$2,210	\$(4,665)	\$3,601

See Notes to Unaudited Interim Consolidated Financial Statements

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## PRUDENTIAL FINANCIAL, INC.

Unaudited Interim Consolidated Statements of Equity  
Six Months Ended June 30, 2018 and 2017 (in millions)

	Prudential Financial, Inc. Equity							
	Common Stock	Additional Paid-in Capital	Retained Earnings	Common Stock Held In Treasury	Accumulated Other Comprehensive Income (Loss)	Total Prudential Financial, Inc. Equity	Noncontrolling Interests	Total Equity
Balance, December 31, 2017	\$6	\$24,769	\$28,671	\$(16,284)	\$17,074	\$54,236	\$275	\$54,511
Cumulative effect of adoption of ASU 2016-01			904		(847)	57		57
Cumulative effect of adoption of ASU 2018-02			(1,653)		1,653	0		0
Common Stock acquired				(750)		(750)		(750)
Contributions from noncontrolling interests							99	99
Distributions to noncontrolling interests							(21)	(21)
Consolidations (deconsolidations) of noncontrolling interests							0	0
Stock-based compensation programs	(6)			129		123		123
Dividends declared on Common Stock			(769)			(769)		(769)
Comprehensive income:								
Net income (loss)			1,560			1,560	4	1,564
Other comprehensive income (loss), net of tax					(6,225)	(6,225)	3	(6,222)
Total comprehensive income (loss)						(4,665)	7	(4,658)
Balance, June 30, 2018	\$6	\$24,763	\$28,713	\$(16,905)	\$11,655	\$48,232	\$360	\$48,592
	Prudential Financial, Inc. Equity							
	Common Stock	Additional Paid-in Capital	Retained Earnings	Common Stock Held In Treasury	Accumulated Other Comprehensive Income (Loss)	Total Prudential Financial, Inc. Equity	Noncontrolling Interests	Total Equity
Balance, December 31, 2016	\$6	\$24,606	\$21,946	\$(15,316)	\$14,621	\$45,863	\$225	\$46,088
Cumulative effect of adoption of accounting changes	5		(5)			0		0
Elimination of Gibraltar Life reporting lag			167			167		167
Common Stock acquired				(625)		(625)		(625)
Contributions from noncontrolling interests							8	8

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Distributions to noncontrolling interests						(27	)	(27	)
Consolidations (deconsolidations) of noncontrolling interests						1		1	
Stock-based compensation programs	60		200		260			260	
Dividends declared on Common Stock		(655	)		(655	)		(655	)
Comprehensive income:									
Net income (loss)		1,860			1,860	8		1,868	
Other comprehensive income (loss), net of tax				1,741	1,741	(19	)	1,722	
Total comprehensive income (loss)					3,601	(11	)	3,590	
Balance, June 30, 2017	\$6	\$24,671	\$23,313	\$(15,741)	\$16,362	\$48,611	\$196	\$48,807	

See Notes to Unaudited Interim Consolidated Financial Statements

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## PRUDENTIAL FINANCIAL, INC.

## Unaudited Interim Consolidated Statements of Cash Flows

Six Months Ended June 30, 2018 and 2017 (in millions)

	2018	2017
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income (loss)	\$1,564	\$1,868
Adjustments to reconcile net income to net cash provided by operating activities:		
Realized investment (gains) losses, net	(1,110 )	665
Policy charges and fee income	(1,058 )	(1,263 )
Interest credited to policyholders' account balances	1,444	1,887
Depreciation and amortization	48	107
(Gains) losses on assets supporting experience-rated contractholder liabilities, net(1)	596	(245 )
Change in:		
Deferred policy acquisition costs	(203 )	(957 )
Future policy benefits and other insurance liabilities	5,762	3,949
Income taxes	(96 )	559
Derivatives, net	(1,041 )	(1,490 )
Other, net(1)	769	(369 )
Cash flows from (used in) operating activities(1)	6,675	4,711
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from the sale/maturity/prepayment of:		
Fixed maturities, available-for-sale	30,599	28,990
Fixed maturities, held-to-maturity	56	89
Fixed maturities, trading(1)	410	897
Assets supporting experience-rated contractholder liabilities(1)	9,650	17,636
Equity securities(1)	1,965	1,984
Commercial mortgage and other loans	2,572	2,630
Policy loans	1,176	1,309
Other invested assets(1)	908	591
Short-term investments(1)	18,190	17,329
Payments for the purchase/origination of:		
Fixed maturities, available-for-sale	(34,922 )	(34,153 )
Fixed maturities, trading(1)	(483 )	(1,080 )
Assets supporting experience-rated contractholder liabilities(1)	(9,560 )	(17,580 )
Equity securities(1)	(1,826 )	(1,646 )
Commercial mortgage and other loans	(5,525 )	(4,494 )
Policy loans	(1,002 )	(915 )
Other invested assets	(1,154 )	(769 )
Short-term investments(1)	(17,138 )	(13,348 )
Acquisition of business, net of cash acquired	0	(64 )
Derivatives, net	(271 )	244
Other, net(1)	(134 )	(297 )
Cash flows from (used in) investing activities(1)	(6,489 )	(2,647 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Policyholders' account deposits	14,826	13,648
Policyholders' account withdrawals	(14,076 )	(12,706 )
Net change in securities sold under agreements to repurchase and cash collateral for loaned securities	1,094	914
Cash dividends paid on Common Stock	(769 )	(653 )

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Net change in financing arrangements (maturities 90 days or less)	(103	) 46
Common Stock acquired	(739	) (612 )
Common Stock reissued for exercise of stock options	74	161
Proceeds from the issuance of debt (maturities longer than 90 days)	1,194	321
Repayments of debt (maturities longer than 90 days)	(848	) (216 )
Other, net	(244	) (451 )
Cash flows from (used in) financing activities	409	452
Effect of foreign exchange rate changes on cash balances	(71	) 110
NET INCREASE IN CASH, CASH EQUIVALENTS RESTRICTED CASH AND RESTRICTED CASH EQUIVALENT(1)	524	2,626
CASH, CASH EQUIVALENTS RESTRICTED CASH AND RESTRICTED CASH EQUIVALENT, BEGINNING OF YEAR(1)	14,536	14,181
CASH, CASH EQUIVALENTS RESTRICTED CASH AND RESTRICTED CASH EQUIVALENT, END OF PERIOD(1)	\$15,060	\$16,807
NON-CASH TRANSACTIONS DURING THE PERIOD		
Treasury Stock shares issued for stock-based compensation programs	\$132	\$98
Significant Pension Risk Transfer transactions:		
Assets received, excluding cash and cash equivalents	\$0	\$1,294
Liabilities assumed	977	1,685
Net cash received	\$977	\$391
Acquisition:		
Assets acquired, excluding cash and cash equivalents	\$0	\$196
Liabilities assumed	0	132
Net cash paid on acquisition	\$0	\$64
RECONCILIATION TO STATEMENT OF FINANCIAL POSITION		
Cash and cash equivalents	\$14,918	\$16,605
Restricted cash and restricted cash equivalents (included in "Other assets")	142	202
Total cash, cash equivalents restricted cash and restricted cash equivalents	\$15,060	\$16,807

(1) Prior period amounts have been reclassified to conform to current period presentation. See Note 2 for details.

See Notes to Unaudited Interim Consolidated Financial Statements

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements

1. BUSINESS AND BASIS OF PRESENTATION

Prudential Financial, Inc. (“Prudential Financial”) and its subsidiaries (collectively, “Prudential” or the “Company”) provide a wide range of insurance, investment management, and other financial products and services to both individual and institutional customers throughout the United States and in many other countries. Principal products and services provided include life insurance, annuities, retirement-related services, mutual funds and investment management.

The Company’s principal operations are comprised of five divisions, which together encompass seven segments, and its Corporate and Other operations. The U.S. Individual Solutions division consists of the Individual Annuities and Individual Life segments. The U.S. Workplace Solutions division consists of the Retirement and Group Insurance segments. The PGIM division is comprised of the PGIM segment, the global investment management businesses of the Company (retitled from the “Investment Management division” and the “Investment Management segment” effective in the second quarter of 2018). The International Insurance division is comprised of the International Insurance segment, and the Closed Block division is comprised of the Closed Block segment. The Closed Block division is accounted for as a divested business that is reported separately from the divested businesses that are included in the Company’s Corporate and Other operations. The Company’s Corporate and Other operations include corporate items and initiatives that are not allocated to business segments and businesses that have been or will be divested, excluding the Closed Block division.

Basis of Presentation

The Unaudited Interim Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) on a basis consistent with reporting interim financial information in accordance with instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission (“SEC”). Intercompany balances and transactions have been eliminated. The Unaudited Interim Consolidated Financial Statements include the accounts of Prudential Financial, entities over which the Company exercises control, including majority-owned subsidiaries and variable interest entities (“VIEs”) in which the Company is considered the primary beneficiary. See Note 4 for more information on the Company’s consolidated variable interest entities.

In the opinion of management, all adjustments necessary for a fair statement of the financial position and results of operations have been made. All such adjustments are of a normal, recurring nature. Interim results are not necessarily indicative of the results that may be expected for the full year. These financial statements should be read in conjunction with the Company’s Consolidated Financial Statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

Elimination of Gibraltar Life Reporting Lag

Prior to January 1, 2018, the Company’s Gibraltar Life Insurance Company, Ltd. (“Gibraltar Life”) consolidated operations used a November 30 fiscal year end for purposes of inclusion in the Company’s Consolidated Financial Statements. The result of this reporting date difference was a one-month reporting lag for Gibraltar Life. As a result, the Company’s unaudited interim consolidated balance sheet as of June 30 previously included the assets and liabilities of Gibraltar Life as of May 31, and the Company’s unaudited interim consolidated income statement previously included Gibraltar Life’s results of operations for the three and six months ended May 31.

Effective January 1, 2018, the Company converted its Gibraltar Life operations to a December 31 fiscal year end. This action eliminated the one-month reporting lag so that the reporting dates and periods of financial balances and results of Gibraltar Life are consistent with those of the Company. The establishment of a new fiscal year end for Gibraltar Life is considered a change in accounting principle to a preferable method and requires retrospective application. The Company believes this change in accounting principle is preferable given that it aligns the reporting dates of Prudential Financial and its subsidiaries which allows for more timely and consistent basis of reporting the financial position and results of Gibraltar Life. In order to effect this elimination, the Company restated prior periods' equity which increased "Retained Earnings" by approximately \$167 million as of December 31, 2015, 2016 and 2017. The impact to the Statements of Operations, Statements of Cash Flows, Statements of Comprehensive Income and other balance sheet captions, as a result of the elimination of the reporting lag, was not material for any of the periods presented.

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Use of Estimates

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

The most significant estimates include those used in determining deferred policy acquisition costs (“DAC”) and related amortization; value of business acquired (“VOBA”) and its amortization; amortization of deferred sales inducements (“DSI”); measurement of goodwill and any related impairment; valuation of investments including derivatives and the recognition of other-than-temporary impairments (“OTTI”); future policy benefits including guarantees; pension and other postretirement benefits; provision for income taxes and valuation of deferred tax assets; and accruals for contingent liabilities, including estimates for losses in connection with unresolved legal and regulatory matters.

Reclassifications

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

2. SIGNIFICANT ACCOUNTING POLICIES AND PRONOUNCEMENTS

Recent Accounting Pronouncements

Changes to U.S. GAAP are established by the Financial Accounting Standards Board (“FASB”) in the form of accounting standards updates (“ASU”) to the FASB Accounting Standards Codification. The Company considers the applicability and impact of all ASU. ASU listed below include those that have been adopted during the current fiscal year and/or those that have been issued but not yet adopted as of the date of this filing. ASU not listed below were assessed and determined to be either not applicable or not material.

Adoption of ASU 2016-01

Effective January 1, 2018, the Company adopted ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Liabilities using a modified retrospective method. Adoption of this ASU impacted the Company’s accounting and presentation related to equity investments. The most significant impact is that the changes in fair value of equity securities previously classified as “available for sale” are to be reported in net income within “Other income” in the Consolidated Statements of Operations. Prior to this, the changes in fair value on equity securities classified as “available for sale” were reported in “Accumulated other comprehensive income.”

The impacts of this ASU on the Company’s Consolidated Financial Statements can be categorized as follows: (1) Changes to the presentation within the Consolidated Statements of Financial Position; (2) Cumulative-effect Adjustment Upon Adoption; and (3) Changes to Accounting Policies. Each of these components is described below. This section is meant to serve as an update to, and should be read in conjunction with, Note 2 to the Consolidated Financial Statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

(1) Changes to the presentation within the Consolidated Statements of Financial Position

Because of the fundamental accounting changes as described in section “—(3) Changes to Accounting Policies” below, the Company determined that changes to the presentation of certain balances in the investment section of the Company’s



Consolidated Statements of Financial Position were also necessary to maintain clarity and logical presentation. The table below illustrates these changes by presenting the balances as previously reported in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 and the reclassifications that were made, along with a footnote explanation of each reclassification.

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Consolidated Statement of Financial Position Line Items	December 31, 2017					As currently reported
	As previously reported	Reclassifications				
	(1)	(2)	(3)	(4)		
	(in millions)					
Fixed maturities, available-for-sale, at fair value	\$346,780					\$346,780
Fixed maturities, held-to-maturity, at amortized cost	2,049					2,049
* Fixed maturities, trading, at fair value	0			3,507		3,507
Trading account assets supporting insurance liabilities, at fair value	22,097	(22,097)				0
* Assets supporting experience-rated contractholder liabilities, at fair value	0	22,097				22,097
Other trading account assets, at fair value	5,752		(5,752)			0
Equity securities, available-for-sale, at fair value	6,174	(6,174)				0
* Equity securities, at fair value	0	6,174	1,155			7,329
Commercial mortgage and other loans	56,045					56,045
Policy loans	11,891					11,891
Other long-term investments	12,308			(12,308)		0
* Other invested assets	0		1,065	12,308		13,373
Short-term investments	6,775		25			6,800
Total investments	\$469,871	\$0	\$0	\$0	\$0	\$469,871

\* — New line item effective January 1, 2018.

Strikethrough — Eliminated line item effective January 1, 2018.

(1) Retitled “Trading account assets supporting insurance liabilities, at fair value” to “Assets supporting experience-rated contractholder liabilities, at fair value” as equity securities are included in this line item, and they can no longer be described as trading.

(2) Retitled “Equity securities, available-for-sale, at fair value” to “Equity securities, at fair value” as equity securities can no longer be described as available-for-sale.

(3) Eliminated the line item “Other trading account assets, at fair value” and reclassified each component to another line item.

(4) Retitled “Other long-term investments” to “Other invested assets.”

## (2) Cumulative-effect Adjustment Upon Adoption

The provisions of ASU 2016-01 require that the Company apply the amendments through a cumulative-effect adjustment to the Consolidated Statements of Financial Position as of the beginning of the fiscal year of adoption. The following table illustrates the impact on the Company’s Consolidated Statement of Financial Position as a result of recording this cumulative-effect adjustment on January 1, 2018.

Summary of ASU 2016-01 Transition Impacts on the Consolidated Statement of Financial Position upon Adoption on January 1, 2018 (in millions)

	Increase / (Decrease)
Other invested assets	\$ 229
Total assets	\$ 229

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Policyholders' dividends	\$ 157
Income taxes	15
Total liabilities	172
Accumulated other comprehensive income (loss)	(847 )
Retained earnings	904
Total equity	57
Total liabilities and equity	\$ 229

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

(3) Changes to Accounting Policies

This section summarizes the changes in our accounting policies resulting from the adoption of ASU 2016-01 as well as an update to the components of the financial statement line items impacted by the Company's Consolidated Statements of Financial Position presentation changes described above.

ASSETS

Fixed maturities, trading is a new financial statement line item comprised of fixed maturities that are carried at fair value. Prior to the adoption of the standard, these fixed maturities were reported in "Other trading account assets, at fair value." These fixed maturities are primarily related to assets associated with consolidated variable interest entities for which the Company is the investment manager and the realized and unrealized gains and losses activity are generally offset by changes in the corresponding liabilities. Realized and unrealized gains and losses on these investments are reported in "Other income," and interest and dividend income from these investments is reported in "Net investment income."

Assets supporting experience-rated contractholder liabilities, at fair value is the new title of the financial statement line item formerly titled "Trading account assets supporting insurance liabilities, at fair value." This financial statement line item includes invested assets that consist of fixed maturities, equity securities, and short-term investments and cash equivalents, that support certain products included in the Retirement and International Insurance segments which are experience-rated, meaning that the investment results associated with these products are expected to ultimately accrue to contractholders. Realized and unrealized gains and losses on these investments are reported in "Other income," and interest and dividend income from these investments is reported in "Net investment income."

Equity securities, at fair value is the new title of the financial statement line item formerly titled "Equity securities, available for sale, at fair value." As a result of the adoption of the standard, equity securities previously reported in "Other trading account asset, at fair value" were reclassified to "Equity securities, at fair value." The retitled financial statement line item is comprised of common stock, mutual fund shares and non-redeemable preferred stock, which are carried at fair value. Realized and unrealized gains and losses on these investments are reported in "Other income," and dividend income is reported in "Net investment income" on the ex-dividend date. Prior to the adoption of the standard, for the equity securities reported in the financial statement line item formerly titled "Equity securities, available for sale, at fair value," the associated net realized gains and losses were included in "Realized investment gains (losses), net" and the associated net unrealized gains and losses were included in "Accumulated other comprehensive income (loss)" ("AOCI"). In addition, with the adoption of the standard, the identification of OTTI for these investments is no longer needed as all of these investments are now measured at fair value with changes in fair value reported in earnings.

Other invested assets is the new title of the financial statement line item formerly titled "Other long-term investments." Investments previously reported in "Other long-term investments" were reclassified to "Other invested assets." The retitled financial statement line item consists of the Company's non-coupon investments in Limited Partnerships and Limited Liability Companies ("LPs/LLCs") (other than operating joint ventures), wholly-owned investment real estate, derivative assets and other investments. LPs/LLCs interests are accounted for using either the equity method of accounting, or at fair value with changes in fair value reported in "Other income." Prior to the adoption of the standard, the Company applied the cost method of accounting for certain LPs/LLCs interests when its partnership interest was considered minor. The standard effectively eliminated the cost method of accounting for these equity investments. The Company's income from investments in LPs/LLCs accounted for using the equity method, other than the Company's investments in operating joint ventures, is included in "Net investment income." The carrying value of these investments is written down, or impaired, to fair value when a decline in value is considered to be other-than-temporary. In

applying the equity method (including assessment for OTTI), the Company uses financial information provided by the investee, generally on a one to three-month lag. For the investments reported at fair value with changes in fair value reported in current earnings, the associated realized and unrealized gains and losses are reported in "Other income." The Company consolidates LPs/LLCs in certain other instances where it is deemed to exercise control, or is considered the primary beneficiary of a variable interest entity. See Note 4 for additional information about VIEs.

#### REVENUES AND BENEFITS AND EXPENSES

Other income includes realized and unrealized gains or losses from investments reported as "Fixed maturities, trading," "Assets supporting experience-rated contractholder liabilities, at fair value," "Equity securities, at fair value," and "Other invested assets" that are measured at fair value.

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Adoption of ASU 2014-09

This section is meant to serve as an update to, and should be read in conjunction with, Note 2 to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017. Effective January 1, 2018, the Company adopted ASU 2014-09, Revenue from Contracts with Customers (Topic 606), using a modified retrospective method. The core principle of this ASU is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This core principle is assessed via application of a five-step revenue recognition model that is detailed within the ASU.

There was no material impact to the financial statements at the date of adoption of this ASU. The prospective impact primarily affects revenue recognition policies pertaining to the Company's investment management business. This revenue is classified within the "Asset management and service fees" line item in the Consolidated Statements of Operations. Adoption of this standard has no impact on revenues related to financial instruments and insurance contracts (some of which may be reflected within "Asset management and service fees") given that these types of revenues were specifically scoped out of this ASU.

"Asset management and service fees" principally includes asset-based asset management fees (which continue to be recognized in the period in which the services are performed) and performance-based incentive fees. Under the previously existing guidance, the Company recorded performance-based incentive fee revenue when the contractual terms of the asset management fee arrangement were satisfied such that the performance fee was no longer subject to clawback or contingency. Under the new guidance, the Company will record this revenue when the contractual terms of the asset management fee arrangement have been satisfied and it is probable that a significant reversal in the amount of the fee will not occur. Under this principle the Company will continue to record a deferred performance-based incentive fee liability to the extent it receives cash related to the performance-based incentive fee prior to meeting the revenue recognition criteria delineated above.

For the three months and six months ended June 30, 2018, respectively, asset management and service fee revenues included \$855 million and \$1,717 million of asset-based management fees, \$6 million and \$11 million of performance-based incentive fees, and \$149 million and \$308 million of other fees. For the three months and six months ended June 30, 2017, respectively, asset management and service fee revenues included \$816 million and \$1,612 million of asset-based management fees, \$5 million and \$12 million of performance-based incentive fees, and \$152 million and \$300 million of other fees. These fees predominantly relate to investment management activities but also include certain asset-based fees associated with insurance contracts. In accordance with the provisions of the ASU, the comparative information for the prior period was not restated and continues to be reported under the accounting standards in effect for that period.

Other ASU adopted during the six months ended June 30, 2018

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Standard	Description	Effective date and method of adoption	Effect on the financial statements or other significant matters
ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a Consensus of the Emerging Issues Task Force)	<p>This ASU addresses diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The standard provides clarity on the treatment of eight specifically defined types of cash inflows and outflows.</p> <p>In November 2016, the FASB issued this ASU to address diversity in practice from entities classifying and presenting transfers between cash and restricted cash as operating, investing, or financing activities, or as a combination of those activities in the Statement of Cash Flows. The ASU requires entities to show the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the Statement of Cash Flows. As a result, transfers between such categories will no longer be presented in the Statement of Cash Flows.</p>	January 1, 2018 using the retrospective method (with early adoption permitted provided that all amendments are adopted in the same period).	Adoption of the ASU did not have a significant impact on the Company's Consolidated Financial Statements and Notes to the Consolidated Financial Statements.
ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash	<p>In November 2016, the FASB issued this ASU to address diversity in practice from entities classifying and presenting transfers between cash and restricted cash as operating, investing, or financing activities, or as a combination of those activities in the Statement of Cash Flows. The ASU requires entities to show the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the Statement of Cash Flows. As a result, transfers between such categories will no longer be presented in the Statement of Cash Flows.</p>	January 1, 2018 using the retrospective method (with early adoption permitted).	Adoption of the ASU did not have a significant impact on the Company's Consolidated Financial Statements and Notes to the Consolidated Financial Statements.
ASU 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income	In February 2018, this ASU was issued following the enactment of the Tax Act of 2017. This ASU allows an entity to elect a reclassification from accumulated other comprehensive income to retained earnings for stranded effects resulting from the Tax Act of 2017.	January 1, 2019 with early adoption permitted. The ASU should be applied either in the period of adoption or retrospectively to each period in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Act of 2017 is recognized.	The Company early adopted the ASU effective January 1, 2018 and elected to apply the ASU in the period of adoption subsequent to recording the adoption impacts of ASU 2016-01 as described above. As a result, the Company reclassified stranded effects resulting from the Tax Act of 2017 by increasing accumulated other comprehensive income and decreasing retained earnings, each by \$1,653 million. Stranded effects unrelated to the Tax Act of 2017 are generally released from accumulated

other comprehensive income when an entire portfolio of the type of item related to the stranded effect is liquidated, sold or extinguished (i.e., portfolio approach).

ASU issued but not yet adopted as of June 30, 2018



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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Standard	Description	Effective date and method of adoption	Effect on the financial statements or other significant matters
ASU 2016-02, Leases (Topic 842)	This ASU ensures that assets and liabilities from all outstanding lease contracts are recognized on the balance sheet (with limited exception). The ASU substantially changes a Lessee’s accounting for leases and requires the recording on balance sheet of a “right-of-use” asset and liability to make lease payments for most leases. A Lessee will continue to recognize expense in its income statement in a manner similar to the requirements under the current lease accounting standard. For Lessors, the standard modifies classification criteria and accounting for sales-type and direct financing leases and requires a Lessor to derecognize the carrying value of the leased asset that is considered to have been transferred to a Lessee and record a lease receivable and residual asset (“receivable and residual” approach). The standard also eliminates the real estate specific provisions of the current standard (i.e., sale-leaseback).	January 1, 2019 using either the modified retrospective method with a cumulative effect adjustment as of the earliest period presented or the optional transition method with a cumulative effect adjustment recorded as of the beginning of the fiscal year of adoption. Early adoption is permitted.	The Company is currently assessing the impact of the ASU on the Company’s Consolidated Financial Statements and Notes to the Consolidated Financial Statements. Upon adoption, we expect to apply the optional transition method and record a right-of-use asset and liability on our balance sheet related to existing operating leases. Any new lease arrangements and/or significant modifications entered into subsequent to the adoption date will be accounted for in accordance with the new standard.
ASU 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments	This ASU provides a new current expected credit loss model to account for credit losses on certain financial assets and off-balance sheet exposures (e.g., loans held for investment, debt securities held to maturity, reinsurance receivables, net investments in leases and loan commitments). The model requires an entity to estimate lifetime credit losses related to such financial assets and exposures based on relevant information about past events, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. The standard also modifies the current OTTI standard for available-for-sale	January 1, 2020 using the modified retrospective method which will include a cumulative-effect adjustment on the balance sheet as of the beginning of the fiscal year of adoption. However, prospective application is required for purchased credit deteriorated assets previously accounted for under ASU 310-30 and for debt securities for which an OTTI was recognized prior to the date of adoption. Early adoption is permitted	The Company is currently assessing the impact of the ASU on the Company’s Consolidated Financial Statements and Notes to the Consolidated Financial Statements.

debt securities to require the use of an allowance rather than a direct write down of the investment, and replaces the existing standard for purchased credit deteriorated loans and debt securities.

This ASU simplifies the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test in current U.S. GAAP, which measures a goodwill impairment by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of the goodwill. Under the ASU, a goodwill impairment should be recorded for the amount by which the carrying amount of a reporting unit exceeds its fair value (capped by the total amount of goodwill allocated to the reporting unit).

beginning January 1, 2019.

January 1, 2020 using the prospective method (with early adoption permitted).

The Company does not expect the adoption of the ASU to have a significant impact on the Company's Consolidated Financial Statements and Notes to the Consolidated Financial Statements.

ASU 2017-04,  
Intangibles -  
Goodwill and Other  
(Topic 350):  
Simplifying the Test  
for Goodwill  
Impairment

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Standard	Description	Effective date and method of adoption	Effect on the financial statements or other significant matters
ASU 2017-08, Receivables -Nonrefundable Fees and Other Costs (Subtopic 310-20) Premium Amortization on Purchased Callable Debt Securities	This ASU requires certain premiums on callable debt securities to be amortized to the earliest call date.	January 1, 2019 using the modified retrospective method (with early adoption permitted) which will include a cumulative-effect adjustment on the balance sheet as of the beginning of the fiscal year of adoption.	The Company does not expect the adoption of the ASU to have a significant impact on the Company's Consolidated Financial Statements and Notes to the Consolidated Financial Statements.
ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities	This ASU makes targeted changes to the existing hedge accounting model to better portray the economics of an entity's risk management activities and to simplify the use of hedge accounting.	January 1, 2019 using the modified retrospective method (with early adoption permitted) which will include a cumulative-effect adjustment on the balance sheet as of the beginning of the fiscal year of adoption.	The Company does not expect the adoption of the ASU to have a significant impact on the Company's Consolidated Financial Statements and Notes to the Consolidated Financial Statements.

## 3. INVESTMENTS

## Fixed Maturity Securities

The following tables set forth information relating to fixed maturity securities (excluding investments classified as trading), as of the dates indicated:

	June 30, 2018				
	Amortized Cost (in millions)	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	OTTI in AOCI(4)
Fixed maturities, available-for-sale:					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$22,471	\$ 2,987	\$ 613	\$24,845	\$ 0
Obligations of U.S. states and their political subdivisions	9,548	771	40	10,279	0
Foreign government bonds	93,464	15,787	414	108,837	0
U.S. corporate public securities	79,744	4,674	2,058	82,360	(4 )
U.S. corporate private securities(1)	32,171	1,269	556	32,884	(11 )
Foreign corporate public securities	26,949	2,290	355	28,884	(5 )
Foreign corporate private securities	24,099	622	760	23,961	0
Asset-backed securities(2)	12,860	195	24	13,031	(172 )
Commercial mortgage-backed securities	13,093	58	305	12,846	0
Residential mortgage-backed securities(3)	3,149	118	43	3,224	(1 )
Total fixed maturities, available-for-sale(1)	\$317,548	\$ 28,771	\$ 5,168	\$341,151	\$ (193 )



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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	June 30, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in millions)			
Fixed maturities, held-to-maturity:				
Foreign government bonds	\$878	\$ 271	\$ 0	\$1,149
Foreign corporate public securities	662	67	0	729
Foreign corporate private securities(5)	85	3	0	88
Commercial mortgage-backed securities	0	0	0	0
Residential mortgage-backed securities(3)	395	27	0	422
Total fixed maturities, held-to-maturity(5)	\$2,020	\$ 368	\$ 0	\$2,388

(1) Excludes notes with amortized cost of \$3,666 million (fair value, \$3,666 million), which have been offset with the associated payables under a netting agreement.

(2) Includes credit-tranched securities collateralized by loan obligations, sub-prime mortgages, auto loans, credit cards, education loans and other asset types.

(3) Includes publicly-traded agency pass-through securities and collateralized mortgage obligations.

(4) Represents the amount of unrealized losses remaining in AOCI, from the impairment measurement date. Amount excludes \$409 million of net unrealized gains on impaired available-for-sale securities and \$1 million of net unrealized gains on impaired held-to-maturity securities relating to changes in the value of such securities subsequent to the impairment measurement date.

(5) Excludes notes with amortized cost of \$4,753 million (fair value, \$4,754 million), which have been offset with the associated payables under a netting agreement.

	December 31, 2017				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	OTTI in AOCI(4)
	(in millions)				
Fixed maturities, available-for-sale:					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$22,837	\$ 3,647	\$ 346	\$26,138	\$ 0
Obligations of U.S. states and their political subdivisions	9,366	1,111	6	10,471	0
Foreign government bonds	88,062	15,650	293	103,419	0
U.S. corporate public securities	81,967	8,671	414	90,224	(10 )
U.S. corporate private securities(1)	31,852	2,051	169	33,734	(13 )
Foreign corporate public securities	26,389	3,118	99	29,408	(5 )
Foreign corporate private securities	23,322	1,242	337	24,227	0
Asset-backed securities(2)	11,965	278	10	12,233	(237 )
Commercial mortgage-backed securities	13,134	238	91	13,281	0
Residential mortgage-backed securities(3)	3,491	165	11	3,645	(2 )
Total fixed maturities, available-for-sale(1)	\$312,385	\$ 36,171	\$ 1,776	\$346,780	\$ (267 )

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in millions)			
Fixed maturities, held-to-maturity:				
Foreign government bonds	\$865	\$ 265	\$ 0	\$1,130
Foreign corporate public securities	654	82	0	736
Foreign corporate private securities(5)	84	2	0	86
Commercial mortgage-backed securities	0	0	0	0
Residential mortgage-backed securities(3)	446	32	0	478
Total fixed maturities, held-to-maturity(5)	\$2,049	\$ 381	\$ 0	\$2,430

(1) Excludes notes with amortized cost of \$2,660 million (fair value, \$2,660 million), which have been offset with the associated payables under a netting agreement.

(2) Includes credit-tranched securities collateralized by loan obligations, sub-prime mortgages, auto loans, credit cards, education loans and other asset types.

(3) Includes publicly-traded agency pass-through securities and collateralized mortgage obligations.

(4) Represents the amount of unrealized losses remaining in AOCI, from the impairment measurement date. Amount excludes \$553 million of net unrealized gains on impaired available-for-sale securities and \$2 million of net unrealized gains on impaired held-to-maturity securities relating to changes in the value of such securities subsequent to the impairment measurement date.

(5) Excludes notes with amortized cost of \$4,627 million (fair value, \$4,913 million), which have been offset with the associated payables under a netting agreement.

The following tables set forth the fair value and gross unrealized losses aggregated by investment category and length of time that individual fixed maturity securities had been in a continuous unrealized loss position, as of the dates indicated:

	June 30, 2018					
	Less Than Twelve Months		Twelve Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(in millions)					
Fixed maturities(1):						
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$5,105	\$ 125	\$4,940	\$ 488	\$10,045	\$ 613
Obligations of U.S. states and their political subdivisions	1,514	25	252	15	1,766	40
Foreign government bonds	5,039	221	2,737	193	7,776	414
U.S. corporate public securities	36,466	1,451	5,579	607	42,045	2,058
U.S. corporate private securities	14,045	382	2,242	174	16,287	556
Foreign corporate public securities	7,626	242	1,348	113	8,974	355
Foreign corporate private securities	9,568	357	3,161	403	12,729	760
Asset-backed securities	6,825	19	285	5	7,110	24

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Commercial mortgage-backed securities	6,705	165	2,057	140	8,762	305
Residential mortgage-backed securities	1,149	29	292	14	1,441	43
Total	\$94,042	\$ 3,016	\$22,893	\$ 2,152	\$116,935	\$ 5,168

(1) Includes \$13 million of fair value and less than \$1 million of gross unrealized losses, which are not reflected in AOCI, on securities classified as held-to-maturity, as of June 30, 2018.

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	December 31, 2017					
	Less Than Twelve Months		Twelve Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(in millions)					
Fixed maturities(1):						
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$3,450	\$ 28	\$6,391	\$ 318	\$9,841	\$ 346
Obligations of U.S. states and their political subdivisions	44	0	287	6	331	6
Foreign government bonds	4,417	55	2,937	238	7,354	293
U.S. corporate public securities	7,914	110	6,831	304	14,745	414
U.S. corporate private securities	4,596	76	2,009	93	6,605	169
Foreign corporate public securities	2,260	21	1,678	78	3,938	99
Foreign corporate private securities	1,213	20	5,339	317	6,552	337
Asset-backed securities	564	2	366	8	930	10
Commercial mortgage-backed securities	2,593	17	2,212	74	4,805	91
Residential mortgage-backed securities	584	4	286	7	870	11
Total	\$27,635	\$ 333	\$28,336	\$ 1,443	\$55,971	\$ 1,776

(1) Includes \$12 million of fair value and less than \$1 million of gross unrealized losses, which are not reflected in AOCI, on securities classified as held-to-maturity, as of December 31, 2017.

As of June 30, 2018 and December 31, 2017, the gross unrealized losses on fixed maturity securities were composed of \$4,639 million and \$1,470 million, respectively, related to “1” highest quality or “2” high quality securities based on the National Association of Insurance Commissioners (“NAIC”) or equivalent rating and \$529 million and \$306 million, respectively, related to other than high or highest quality securities based on NAIC or equivalent rating. As of June 30, 2018, the \$2,152 million of gross unrealized losses on fixed maturity securities of twelve months or more were concentrated in U.S. government bonds and in the Company’s corporate securities within the consumer non-cyclical and utility sectors. As of December 31, 2017, the \$1,443 million of gross unrealized losses on fixed maturity securities of twelve months or more were concentrated in U.S. government bonds, foreign government bonds and in the Company’s corporate securities within the energy, utility and consumer non-cyclical sectors. In accordance with its policy described in Note 2 to the Consolidated Financial Statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017, the Company concluded that an adjustment to earnings for OTTI for these fixed maturity securities was not warranted at either June 30, 2018 or December 31, 2017. These conclusions were based on a detailed analysis of the underlying credit and cash flows on each security. Gross unrealized losses are primarily attributable to general credit spread widening, increases in interest rates and foreign currency exchange rate movements. As of June 30, 2018, the Company did not intend to sell these securities, and it was not more likely than not that the Company would be required to sell these securities before the anticipated recovery of the remaining amortized cost basis.

The following table sets forth the amortized cost and fair value of fixed maturities by contractual maturities, as of the date indicated:



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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	June 30, 2018			
	Available-for-Sale Amortized Fair Cost Value		Held-to-Maturity Amortized Fair Cost Value	
	(in millions)			
Fixed maturities:				
Due in one year or less	\$ 10,769	\$ 11,156	\$ 7	\$ 7
Due after one year through five years	50,932	53,917	171	176
Due after five years through ten years	63,671	66,989	572	636
Due after ten years(1)	163,074	179,988	875	1,147
Asset-backed securities	12,860	13,031	0	0
Commercial mortgage-backed securities	13,093	12,846	0	0
Residential mortgage-backed securities	3,149	3,224	395	422
Total	\$ 317,548	\$ 341,151	\$ 2,020	\$ 2,388

Excludes available-for-sale notes with amortized cost of \$3,666 million (fair value, \$3,666 million) and (1) held-to-maturity notes with amortized cost of \$4,753 million (fair value, \$4,754 million), which have been offset with the associated payables under a netting agreement.

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

The following table sets forth the sources of fixed maturity proceeds and related investment gains (losses), as well as losses on impairments of fixed maturities, for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
	(in millions)			
Fixed maturities, available-for-sale:				
Proceeds from sales(1)	\$ 9,489	\$ 8,157	\$ 19,074	\$ 15,887
Proceeds from maturities/prepayments	6,553	7,546	11,779	13,420
Gross investment gains from sales and maturities	410	410	784	801
Gross investment losses from sales and maturities	(187 )	(135 )	(444 )	(298 )
OTTI recognized in earnings(2)	(58 )	(46 )	(97 )	(100 )
Fixed maturities, held-to-maturity:				
Proceeds from maturities/prepayments(3)	\$ 23	\$ 39	\$ 59	\$ 89

(1) Includes \$254 million and \$317 million of non-cash related proceeds due to the timing of trade settlements for the six months ended June 30, 2018 and 2017, respectively.

(2) Excludes the portion of OTTI amounts remaining in “Other comprehensive income (loss)” (“OCI”), representing any difference between the fair value of the impaired debt security and the net present value of its projected future cash flows at the time of impairment.

(3) Includes \$3 million and \$0 million of non-cash related proceeds due to the timing of trade settlements for the six months ended June 30, 2018 and 2017, respectively.

The following table sets forth a rollforward of pre-tax amounts remaining in OCI related to fixed maturity securities with credit loss impairments recognized in earnings, for the periods indicated:

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Three Months Ended June 30, 2018	Six Months Ended June 30, 2018	Three Months Ended June 30, 2017	Six Months Ended June 30, 2017
	(in millions)			
Credit loss impairments:				
Balance, beginning of period	\$ 203	\$ 319	\$ 350	\$ 359
New credit loss impairments	0	0	7	7
Additional credit loss impairments on securities previously impaired	0	0	0	1
Increases due to the passage of time on previously recorded credit losses	4	6	4	7
Reductions for securities which matured, paid down, prepaid or were sold during the period	(42 )	(155 )	(7 )	(16 )
Reductions for securities impaired to fair value during the period(1)	0	(4 )	(11 )	(14 )
Accretion of credit loss impairments previously recognized due to an increase in cash flows expected to be collected	(2 )	(3 )	(2 )	(3 )
Balance, end of period	\$ 163	\$ 163	\$ 341	\$ 341

(1) Represents circumstances where the Company determined in the current period that it intends to sell the security or it is more likely than not that it will be required to sell the security before recovery of the security's amortized cost.

## Assets Supporting Experience-Rated Contractholder Liabilities

The following table sets forth the composition of "Assets supporting experience-rated contractholder liabilities," as of the dates indicated:

	June 30, 2018		December 31, 2017	
	Amortized Cost or Cost	Fair Value	Amortized Cost or Cost	Fair Value
	(in millions)			
Short-term investments and cash equivalents	\$340	\$340	\$245	\$245
Fixed maturities:				
Corporate securities	13,263	13,140	13,816	14,073
Commercial mortgage-backed securities	2,390	2,350	2,294	2,311
Residential mortgage-backed securities(1)	888	867	961	966
Asset-backed securities(2)	1,470	1,493	1,363	1,392
Foreign government bonds	1,063	1,061	1,050	1,057
U.S. government authorities and agencies and obligations of U.S. states	579	619	357	410
Total fixed maturities	19,653	19,530	19,841	20,209
Equity securities	1,367	1,627	1,278	1,643
Total assets supporting experience-rated contractholder liabilities	\$21,360	\$21,497	\$21,364	\$22,097

(1) Includes publicly-traded agency pass-through securities and collateralized mortgage obligations.

(2)

Includes credit-tranched securities collateralized by sub-prime mortgages, auto loans, credit cards, education loans and other asset types.

The net change in unrealized gains (losses) from assets supporting experience-rated contractholder liabilities still held at period end, recorded within "Other income," was \$(198) million and \$183 million during the three months ended June 30, 2018 and 2017, respectively, and \$(596) million and \$229 million during the six months ended June 30, 2018 and 2017, respectively.

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

## Equity Securities

The net change in unrealized gains (losses) from equity securities still held at period end, recorded within “Other income,” was \$(80) million and \$11 million during the three months ended June 30, 2018 and 2017, respectively.

The net change in unrealized gains (losses) from equity securities still held at period end, recorded within “Other income,” was \$(271) million and \$54 million during the six months ended June 30, 2018 and 2017, respectively.

## Concentrations of Financial Instruments

The Company monitors its concentrations of financial instruments and mitigates credit risk by maintaining a diversified investment portfolio which limits exposure to any one issuer.

As of the dates indicated, the Company’s exposure to concentrations of credit risk of single issuers greater than 10% of the Company’s stockholders’ equity included securities of the U.S. government and certain U.S. government agencies and securities guaranteed by the U.S. government, as well as the securities disclosed below:

	June 30, 2018		December 31, 2017	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Investments in Japanese government and government agency securities:				
Fixed maturities, available-for-sale	\$69,248	\$81,731	\$64,628	\$76,311
Fixed maturities, held-to-maturity	857	1,122	844	1,103
Fixed maturities, trading	23	23	23	23
Assets supporting experience-rated contractholder liabilities	676	686	657	667
Total	\$70,804	\$83,562	\$66,152	\$78,104

	June 30, 2018		December 31, 2017	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Investments in South Korean government and government agency securities:				
Fixed maturities, available-for-sale	\$9,646	\$10,988	\$9,425	\$10,989
Fixed maturities, held-to-maturity	0	0	0	0
Fixed maturities, trading	0	0	0	0
Assets supporting experience-rated contractholder liabilities	15	15	15	15
Total	\$9,661	\$11,003	\$9,440	\$11,004

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

## Commercial Mortgage and Other Loans

The following table sets forth the composition of “Commercial mortgage and other loans,” as of the dates indicated:

	June 30, 2018		December 31, 2017	
	Amount (in million)	% of Total	Amount (in million)	% of Total
Commercial mortgage and agricultural property loans by property type:				
Office	\$13,435	23.2 %	\$12,670	22.9 %
Retail	8,707	15.1	8,543	15.5
Apartments/Multi-Family	16,194	28.0	15,465	28.0
Industrial	10,609	18.3	9,451	17.1
Hospitality	1,965	3.4	2,067	3.7
Other	3,784	6.5	3,888	7.0
Total commercial mortgage loans	54,694	94.5	52,084	94.2
Agricultural property loans	3,206	5.5	3,203	5.8
Total commercial mortgage and agricultural property loans by property type	57,900	100.0%	55,287	100.0%
Valuation allowance	(119 )		(100 )	
Total net commercial mortgage and agricultural property loans by property type	57,781		55,187	
Other loans:				
Uncollateralized loans	666		663	
Residential property loans	176		196	
Other collateralized loans	4		5	
Total other loans	846		864	
Valuation allowance	(5 )		(6 )	
Total net other loans	841		858	
Total commercial mortgage and other loans(1)	\$58,622		\$56,045	

Includes loans held for sale which are carried at fair value and are collateralized primarily by apartment complexes.

(1) As of June 30, 2018 and December 31, 2017, the net carrying value of these loans was \$330 million and \$593 million, respectively.

As of June 30, 2018, the commercial mortgage and agricultural property loans were secured by properties geographically dispersed throughout the United States (with the largest concentrations in California (28%), Texas (9%) and New York (8%) and included loans secured by properties in Europe (6%), Australia (1%) and Asia (1%).

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

The following tables set forth the activity in the allowance for credit losses for commercial mortgage and other loans, as of the dates indicated:

	June 30, 2018						Total
	Commercial Mortgage Loans	Agricultural Property Loans	Residential Property Loans	Other Collateralized Loans	Uncollateralized Loans		
	(in millions)						
Allowance for credit losses:							
Balance, beginning of year	\$97	\$ 3	\$ 1	\$ 0	\$ 5		\$106
Addition to (release of) allowance for losses	19	0	0	0	(1	)	18
Charge-offs, net of recoveries	0	0	0	0	0		0
Change in foreign exchange	0	0	0	0	0		0
Total ending balance	\$116	\$ 3	\$ 1	\$ 0	\$ 4		\$124

	December 31, 2017						Total	
	Commercial Mortgage Loans	Agricultural Property Loans	Residential Property Loans	Other Collateralized Loans	Uncollateralized Loans			
	(in millions)							
Allowance for credit losses:								
Balance, beginning of year	\$96	\$ 2	\$ 2	\$ 0	\$ 6		\$106	
Addition to (release of) allowance for losses	2	1	(1	)	0	(1	)	1
Charge-offs, net of recoveries	(1	)	0	0	0		(1	)
Change in foreign exchange	0	0	0	0	0		0	
Total ending balance	\$97	\$ 3	\$ 1	\$ 0	\$ 5		\$106	

The following tables set forth the allowance for credit losses and the recorded investment in commercial mortgage and other loans, as of the dates indicated:

	June 30, 2018						Total
	Commercial Mortgage Loans	Agricultural Property Loans	Residential Property Loans	Other Collateralized Loans	Uncollateralized Loans		
	(in millions)						
Allowance for credit losses:							
Individually evaluated for impairment	\$20	\$ 0	\$ 0	\$ 0	\$ 0		\$20
Collectively evaluated for impairment	96	3	1	0	4		104
Total ending balance(1)	\$116	\$ 3	\$ 1	\$ 0	\$ 4		\$124
Recorded investment(2):							
Individually evaluated for impairment	\$70	\$ 35	\$ 0	\$ 0	\$ 2		\$107
Collectively evaluated for impairment	54,624	3,171	176	4	664		58,639
Total ending balance(1)	\$54,694	\$ 3,206	\$ 176	\$ 4	\$ 666		\$58,746

(1) As of June 30, 2018, there were no loans acquired with deteriorated credit quality.

(2) Recorded investment reflects the carrying value gross of related allowance.





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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	December 31, 2017					Total
	Commercial Mortgage Loans	Agricultural Property Loans	Residential Property Loans	Other Collateralized Loans	Uncollateralized Loans	
	(in millions)					
Allowance for credit losses:						
Individually evaluated for impairment	\$ 7	\$ 0	\$ 0	\$ 0	\$ 0	\$ 7
Collectively evaluated for impairment	90	3	1	0	5	99
Total ending balance(1)	\$ 97	\$ 3	\$ 1	\$ 0	\$ 5	\$ 106
Recorded investment(2):						
Individually evaluated for impairment	\$ 75	\$ 39	\$ 0	\$ 0	\$ 2	\$ 116
Collectively evaluated for impairment	52,009	3,164	196	5	661	56,035
Total ending balance(1)	\$ 52,084	\$ 3,203	\$ 196	\$ 5	\$ 663	\$ 56,151

(1) As of December 31, 2017, there were no loans acquired with deteriorated credit quality.

(2) Recorded investment reflects the carrying value gross of related allowance.

The following tables set forth certain key credit quality indicators based upon the recorded investment gross of allowance for credit losses, as of the date indicated:

## Commercial mortgage loans

	June 30, 2018			
	Debt Service Coverage Ratio			
	>1.2X	1.0X to <1.2X	<1.0X	Total
	(in millions)			
Loan-to-Value Ratio:				
0%-59.99%	\$ 29,292	\$ 520	\$ 281	\$ 30,093
60%-69.99%	16,737	579	155	17,471
70%-79.99%	6,047	807	11	6,865
80% or greater	60	182	23	265
Total commercial mortgage loans	\$ 52,136	\$ 2,088	\$ 470	\$ 54,694

## Agricultural property loans

	June 30, 2018			
	Debt Service Coverage Ratio			
	>1.2X	1.0X to <1.2X	<1.0X	Total
	(in millions)			
Loan-to-Value Ratio:				
0%-59.99%	\$ 2,955	\$ 176	\$ 0	\$ 3,131
60%-69.99%	75	0	0	75
70%-79.99%	0	0	0	0
80% or greater	0	0	0	0
Total agricultural property loans	\$ 3,030	\$ 176	\$ 0	\$ 3,206



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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

## Total commercial mortgage and agricultural property loans

	June 30, 2018			
	Debt Service Coverage Ratio			
	>1.2X	1.0X to <1.2X	< 1.0X	Total
	(in millions)			
Loan-to-Value Ratio:				
0%-59.99%	\$32,247	\$ 696	\$ 281	\$33,224
60%-69.99%	16,812	579	155	17,546
70%-79.99%	6,047	807	11	6,865
80% or greater	60	182	23	265
Total commercial mortgage and agricultural property loans	\$55,166	\$ 2,264	\$ 470	\$57,900

The following tables set forth certain key credit quality indicators based upon the recorded investment gross of allowance for credit losses, as of the date indicated:

## Commercial mortgage loans

	December 31, 2017			
	Debt Service Coverage Ratio			
	>1.2X	1.0X to <1.2X	< 1.0X	Total
	(in millions)			
Loan-to-Value Ratio:				
0%-59.99%	\$30,082	\$ 639	\$ 251	\$30,972
60%-69.99%	13,658	530	121	14,309
70%-79.99%	5,994	514	29	6,537
80% or greater	93	54	119	266
Total commercial mortgage loans	\$49,827	\$ 1,737	\$ 520	\$52,084

## Agricultural property loans

	December 31, 2017			
	Debt Service Coverage Ratio			
	>1.2X	1.0X to <1.2X	< 1.0X	Total
	(in millions)			
Loan-to-Value Ratio:				
0%-59.99%	\$2,988	\$ 170	\$ 5	\$3,163
60%-69.99%	40	0	0	40
70%-79.99%	0	0	0	0
80% or greater	0	0	0	0
Total agricultural property loans	\$3,028	\$ 170	\$ 5	\$3,203

## Total commercial mortgage and agricultural property loans

December 31, 2017			
Debt Service Coverage Ratio			
>1.2X	1.0X to <1.2X	Total	

			<	
			1.0X	
	(in millions)			
Loan-to-Value Ratio:				
0%-59.99%	\$33,070	\$ 809	\$256	\$34,135
60%-69.99%	13,698	530	121	14,349
70%-79.99%	5,994	514	29	6,537
80% or greater	93	54	119	266
Total commercial mortgage and agricultural property loans	\$52,855	\$ 1,907	\$525	\$55,287

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

The following tables set forth an aging of past due commercial mortgage and other loans based upon the recorded investment gross of allowance for credit losses, as well as the amount of commercial mortgage and other loans on non-accrual status, as of the dates indicated:

June 30, 2018							
Current	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due(1)	Total Past Due	Total Loans	Non-Accrual Status(2)	
(in millions)							
Commercial mortgage loans	\$54,694	\$ 0	\$ 0	\$ 0	\$ 0	\$54,694	\$ 70
Agricultural property loans	3,190	0	0	16	16	3,206	23
Residential property loans	172	1	1	2	4	176	2
Other collateralized loans	4	0	0	0	0	4	0
Uncollateralized loans	666	0	0	0	0	666	0
Total	\$58,726	\$ 1	\$ 1	\$ 18	\$ 20	\$58,746	\$ 95

(1) As of June 30, 2018, there were no loans in this category accruing interest.

For additional information regarding the Company's policies for accruing interest on loans, see Note 2 to the

(2) Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

December 31, 2017							
Current	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due(1)	Total Past Due	Total Loans	Non-Accrual Status(2)	
(in millions)							
Commercial mortgage loans	\$52,084	\$ 0	\$ 0	\$ 0	\$ 0	\$52,084	\$ 71
Agricultural property loans	3,201	0	0	2	2	3,203	23
Residential property loans	191	3	0	2	5	196	2
Other collateralized loans	5	0	0	0	0	5	0
Uncollateralized loans	663	0	0	0	0	663	0
Total	\$56,144	\$ 3	\$ 0	\$ 4	\$ 7	\$56,151	\$ 96

(1) As of December 31, 2017, there were no loans in this category accruing interest.

For additional information regarding the Company's policies for accruing interest on loans, see Note 2 to the

(2) Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

## Other Invested Assets

The following table sets forth the composition of “Other invested assets,” as of the dates indicated:

	June 30, December 31,	
	2018	2017
	(in millions)	
LPs/LLCs:		
Equity method:		
Private equity	\$2,927	\$ 2,954
Hedge funds	1,021	803
Real estate-related	1,171	972
Subtotal equity method	5,119	4,729
Fair value:		
Private equity	1,608	1,325
Hedge funds	2,307	2,419
Real estate-related	293	247
Subtotal fair value(1)	4,208	3,991
Total LPs/LLCs	9,327	8,720
Real estate held through direct ownership(2)	2,278	2,409
Derivative instruments	820	1,214
Other(3)	1,034	1,030
Total other invested assets(4)	\$13,459	\$ 13,373

(1) As of December 31, 2017, \$1,572 million was accounted for using the cost method.

(2) As of June 30, 2018 and December 31, 2017, real estate held through direct ownership had mortgage debt of \$751 million and \$799 million, respectively.

Primarily includes strategic investments made by investment management operations, leveraged leases and member and activity stock held in the Federal Home Loan Banks of New York and Boston. For additional information regarding the Company’s holdings in the Federal Home Loan Banks of New York and Boston, see Note 14 to the Consolidated Financial Statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

(3) Prior period amounts have been reclassified to conform to current period presentation. For additional information, see Note 2.

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

## Net Investment Income

The following table sets forth “Net investment income” by investment type, for the periods indicated:

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2017	
	2018	2017	2018	2017
	(in millions)			
Fixed maturities, available-for-sale(1)	\$3,001	\$2,856	\$5,955	\$5,651
Fixed maturities, held-to-maturity(1)	57	54	112	108
Fixed maturities, trading	30	45	61	87
Assets supporting experience-rated contractholder liabilities, at fair value	181	177	372	372
Equity securities, at fair value	59	114	94	204
Commercial mortgage and other loans	594	583	1,163	1,120
Policy loans	156	155	308	307
Other invested assets	163	248	304	580
Short-term investments and cash equivalents	82	46	154	90
Gross investment income	4,323	4,278	8,523	8,519
Less: investment expenses	(227 )	(189 )	(429 )	(369 )
Net investment income(2)	\$4,096	\$4,089	\$8,094	\$8,150

(1) Includes income on credit-linked notes which are reported on the same financial statement line item as related surplus notes, as conditions are met for right to offset.

(2) Prior period amounts have been reclassified to conform to current period presentation.

## Realized Investment Gains (Losses), Net

The following table sets forth “Realized investment gains (losses), net,” by investment type, for the periods indicated:

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2017	
	2018	2017	2018	2017
	(in millions)			
Fixed maturities(1)	\$165	\$229	\$243	\$403
Equity securities(2)	0	164	0	420
Commercial mortgage and other loans	5	14	17	28
Investment real estate	60	6	62	12
LPs/LLCs	10	(10 )	16	(21 )
Derivatives(3)	445	(1,496 )	773	(1,507)
Other	0	1	(1 )	0
Realized investment gains (losses), net	\$685	\$(1,092)	\$1,110	\$(665)

(1) Includes fixed maturity securities classified as available-for-sale and held-to-maturity and excludes fixed maturity securities classified as trading.

(2) Effective January 1, 2018, realized gains (losses) on equity securities are recorded within "Other income."

(3) Includes the hedged items offset in qualifying fair value hedge accounting relationships.

Net Unrealized Gains (Losses) on Investments within AOCI

The following table sets forth net unrealized gains (losses) on investments, as of the dates indicated:

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	June 30, 2018	December 31, 2017
	(in millions)	
Fixed maturity securities, available-for-sale—with OTIS	\$ 216	\$ 286
Fixed maturity securities, available-for-sale—all other	23,387	34,109
Equity securities, available-for-sale(1)	0	2,027
Derivatives designated as cash flow hedges(2)	99	(39 )
Other investments(3)	(9 )	15
Net unrealized gains (losses) on investments	\$23,693	\$ 36,398

(1) Effective January 1, 2018, unrealized gains (losses) on equity securities are recorded within “Other income.”

(2) For more information on cash flow hedges, see Note 5.

As of June 30, 2018, there were no net unrealized losses on held-to-maturity securities that were previously transferred from available-for-sale. Includes net unrealized gains on certain joint ventures that are strategic in nature and are included in “Other assets.”

## Repurchase Agreements and Securities Lending

In the normal course of business, the Company sells securities under agreements to repurchase and enters into securities lending transactions. The following table sets forth the composition of “Securities sold under agreements to repurchase,” as of the dates indicated:

	June 30, 2018			December 31, 2017		
	Remaining Contractual Maturities of the Agreements Overnight & 30 Days Continued (in millions)	Total		Remaining Contractual Maturities of the Agreements Overnight & 30 Days Continued	Total	
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$8,394	\$ 775	\$9,169	\$911	\$7,349	\$8,260
U.S. corporate public securities	20	0	20	1	0	1
Foreign corporate public securities	0	0	0	0	0	0
Residential mortgage-backed securities	351	0	351	0	139	139
Equity securities	0	0	0	0	0	0
Total securities sold under agreements to repurchase(1)	\$8,765	\$ 775	\$9,540	\$912	\$7,488	\$8,400

(1) The Company did not have any agreements with remaining contractual maturities of thirty days or greater, as of the dates indicated.

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

The following table sets forth the composition of “Cash collateral for loaned securities” which represents the liability to return cash collateral received for the following types of securities loaned, as of the dates indicated:

	June 30, 2018			December 31, 2017		
	Remaining Contractual Maturities of the Agreements Overnight & 30 Continuous Days	Total	(in millions)	Remaining Contractual Maturities of the Agreements Overnight & 30 Continuous Days	Total	(in millions)
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$142	\$161	\$303	\$87	\$35	\$122
Obligations of U.S. states and their political subdivisions	139	0	139	103	0	103
Foreign government bonds	368	0	368	335	0	335
U.S. corporate public securities	2,749	0	2,749	2,961	0	2,961
Foreign corporate public securities	612	0	612	655	0	655
Residential mortgage-backed securities	0	0	0	0	0	0
Equity securities	136	0	136	178	0	178
Total cash collateral for loaned securities(1)	\$4,146	\$161	\$4,307	\$4,319	\$35	\$4,354

(1) The Company did not have any agreements with remaining contractual maturities of thirty days or greater, as of the dates indicated.

## 4. VARIABLE INTEREST ENTITIES

In the normal course of its activities, the Company enters into relationships with various special-purpose entities and other entities that are deemed to be variable interest entities (“VIEs”). For additional information, see Note 5 to the Consolidated Financial Statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

## Consolidated Variable Interest Entities

The table below reflects the carrying amount and balance sheet caption in which the assets and liabilities of consolidated VIEs are reported. The liabilities primarily comprise obligations under debt instruments issued by the VIEs. The creditors of these VIEs do not have recourse to the Company in excess of the assets contained within the VIEs.

	Consolidated VIEs for which the Company is the Investment Manager(1)(2)			
	June 30, 2018	December 31, 2017	June 30, 2018	December 31, 2017
Fixed maturities, available-for-sale	\$75	\$69	\$279	\$275

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Fixed maturities, held-to-maturity	85	83	824	810
Fixed maturities, trading	1,071	1,623	0	0
Assets supporting experience-rated contractholder liabilities	0	0	9	9
Equity securities	38	28	0	0
Commercial mortgage and other loans	652	617	0	0
Other invested assets	1,316	1,390	84	97
Cash and cash equivalents	130	164	0	0
Accrued investment income	5	7	4	4
Other assets	445	440	141	150
Total assets of consolidated VIEs	\$3,817	\$ 4,421	\$ 1,341	\$ 1,345
Other liabilities	\$288	\$ 433	\$ 8	\$ 0
Notes issued by consolidated VIEs(3)	937	1,518	0	0
Total liabilities of consolidated VIEs	\$1,225	\$ 1,951	\$ 8	\$ 0

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

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- (1) Prior period amounts have been reclassified to conform to current period presentation. See Note 2 for additional information.
- (2) Total assets of consolidated VIEs reflect \$1,796 million and \$1,716 million as of June 30, 2018 and December 31, 2017, respectively, related to VIEs whose beneficial interests are wholly-owned by consolidated subsidiaries.
- (3) Recourse is limited to the assets of the respective VIE and does not extend to the general credit of the Company. As of June 30, 2018 and December 31, 2017, the maturities of these obligations were greater than five years.

#### Unconsolidated Variable Interest Entities

The Company has determined that it is not the primary beneficiary of certain VIEs for which it is the investment manager. The Company's maximum exposure to loss resulting from its relationship with unconsolidated VIEs for which it is the investment manager is limited to its investment in the VIEs, which was \$858 million and \$1,013 million at June 30, 2018 and December 31, 2017, respectively. These investments are reflected in "Fixed maturities, available-for-sale," "Fixed maturities, trading," "Equity securities" and "Other invested assets." There are no liabilities associated with these unconsolidated VIEs on the Company's Unaudited Interim Consolidated Statements of Financial Position.

In the normal course of its activities, the Company will invest in LPs/LLCs, which include hedge funds, private equity funds and real estate-related funds and may or may not be VIEs. The Company's maximum exposure to loss on these investments, both VIEs and non-VIEs, is limited to the amount of its investment. The Company classifies these investments as "Other invested assets" and its maximum exposure to loss associated with these entities was \$9,327 million and \$8,720 million as of June 30, 2018 and December 31, 2017, respectively.

In addition, in the normal course of its activities, the Company will invest in structured investments including VIEs for which it is not the investment manager. These structured investments typically invest in fixed income investments and are managed by third-parties and include asset-backed securities, commercial mortgage-backed securities and residential mortgage-backed securities. The Company's maximum exposure to loss on these structured investments, both VIEs and non-VIEs, is limited to the amount of its investment. See Note 3 for details regarding the carrying amounts and classification of these assets. The Company has not provided material financial or other support that was not contractually required to these structures. The Company has determined that it is not the primary beneficiary of these structures due to the fact that it does not control these entities.

#### 5. DERIVATIVE INSTRUMENTS

##### Types of Derivative Instruments and Derivative Strategies

The Company utilizes various derivatives instruments and strategies to manage its risk. Commonly used derivative instruments include, but are not necessarily limited to:

- Interest rate contracts: futures, swaps, options, swaptions, caps and floors
- Equity contracts: futures, options and total return swaps
- Foreign exchange contracts: futures, options, forwards and swaps
- Credit contracts: single and index reference credit default swaps
- Other contracts: to-be-announced ("TBA") forward contracts, loan commitments, embedded derivatives and synthetic guaranteed investment contracts ("GICs").

For detailed information on these contracts and the related strategies, see Note 21 to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

#### Primary Risks Managed by Derivatives

The table below provides a summary of the gross notional amount and fair value of derivatives contracts by the primary underlying risks, excluding embedded derivatives and associated reinsurance recoverables. Many derivative instruments contain multiple underlying risks. The fair value amounts below represent the gross fair value of derivative contracts prior to taking into account the netting effects of master netting agreements, cash collateral and non-performance risk ("NPR"). This netting impact results in total derivative assets of \$812 million and \$1,205 million as of June 30, 2018 and December 31, 2017, respectively, and total derivative liabilities of \$676 million and \$643 million as of June 30, 2018 and December 31, 2017, respectively, reflected in the Unaudited Interim Consolidated Statements of Financial Position.

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Primary Underlying Risk /Instrument Type	June 30, 2018			December 31, 2017		
	Notional	Gross Fair Value		Notional	Gross Fair Value	
	(in millions)	Assets	Liabilities	(in millions)	Assets	Liabilities
Derivatives Designated as Hedge Accounting						
Instruments:						
Interest Rate						
Interest Rate Swaps	\$2,925	\$155	\$(74)	\$3,204	\$271	\$(88)
Foreign Currency						
Foreign Currency Forwards	574	8	0	545	0	(8)
Currency/Interest Rate						
Foreign Currency Swaps	19,272	946	(645)	17,732	766	(735)
Total Qualifying Hedges	\$22,771	\$1,109	\$(719)	\$21,481	\$1,037	\$(831)
Derivatives Not Qualifying as Hedge Accounting						
Instruments:						
Interest Rate						
Interest Rate Swaps	\$150,392	\$5,891	\$(3,856)	\$158,552	\$7,958	\$(3,509)
Interest Rate Futures	18,311	2	(2)	23,792	25	(1)
Interest Rate Options	22,424	170	(259)	18,456	167	(203)
Interest Rate Forwards	2,628	10	0	1,498	6	(2)
Foreign Currency						
Foreign Currency Forwards	23,197	284	(182)	23,905	164	(254)
Foreign Currency Options	46	0	0	59	0	0
Currency/Interest Rate						
Foreign Currency Swaps	13,537	740	(449)	13,777	822	(414)
Credit						
Credit Default Swaps	1,390	18	(6)	1,314	21	(5)
Equity						
Equity Futures	1,031	1	(9)	710	2	(2)
Equity Options	53,838	535	(534)	36,007	588	(364)
Total Return Swaps	19,712	254	(197)	15,558	17	(369)
Other						
Other (2)	504	0	0	0	0	0
Synthetic GICs	77,495	2	0	77,290	0	(1)
Total Non-Qualifying Derivatives	\$384,505	\$7,907	\$(5,494)	\$370,918	\$9,770	\$(5,124)
Total Derivatives(1)	\$407,276	\$9,016	\$(6,213)	\$392,399	\$10,807	\$(5,955)

Excludes embedded derivatives and associated reinsurance recoverables which contain multiple underlying risks.

(1) The fair value of these embedded derivatives was a net liability of \$6,651 million and \$8,748 million as of June 30, 2018 and December 31, 2017, respectively, primarily included in "Future policy benefits."

(2) "Other" primarily includes derivative contracts used to balance the Company's tail longevity and mortality risk. Under these contracts, the Company's gain/loss is capped at the notional amount.

Most of the Company's derivatives do not qualify for hedge accounting for various reasons. For example: (i) derivatives that economically hedge embedded derivatives do not qualify for hedge accounting because changes in the fair value of the embedded derivatives are already recorded in net income; (ii) derivatives that are utilized as macro hedges of the Company's exposure to various risks typically do not qualify for hedge accounting because they do not

meet the criteria required under portfolio hedge accounting rules; and (iii) synthetic GIC, which are product standalone derivatives, do not qualify as hedging instruments under hedge accounting rules.

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

## Offsetting Assets and Liabilities

The following table presents recognized derivative instruments (excluding embedded derivatives and associated reinsurance recoverables), and repurchase and reverse repurchase agreements that are offset in the Unaudited Interim Consolidated Statements of Financial Position, and/or are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in the Unaudited Interim Consolidated Statements of Financial Position.

	June 30, 2018				
	Gross Amounts of Recognized Financial Instrument (in millions)	Gross Amounts Offset in the Statements of Financial Position	Net Amounts Presented in the Statements of Financial Position	Financial Instruments/ Collateral(1)	Net Amount
Offsetting of Financial Assets:					
Derivatives(1)	\$8,933	\$ (8,204 )	\$ 729	\$ (457 )	\$ 272
Securities purchased under agreement to resell	2,339	0	2,339	(2,339 )	0
Total assets	\$11,272	\$ (8,204 )	\$ 3,068	\$ (2,796 )	\$ 272
Offsetting of Financial Liabilities:					
Derivatives(1)	\$6,205	\$ (5,537 )	\$ 668	\$ (452 )	\$ 216
Securities sold under agreement to repurchase	9,540	0	9,540	(9,540 )	0
Total liabilities	\$15,745	\$ (5,537 )	\$ 10,208	\$ (9,992 )	\$ 216
	December 31, 2017				
	Gross Amounts of Recognized Financial Instrument (in millions)	Gross Amounts Offset in the Statements of Financial Position	Net Amounts Presented in the Statements of Financial Position	Financial Instruments/ Collateral(1)	Net Amount
Offsetting of Financial Assets:					
Derivatives(1)	\$10,710	\$ (9,600 )	\$ 1,110	\$ (625 )	\$ 485
Securities purchased under agreement to resell	240	0	240	(240 )	0
Total assets	\$10,950	\$ (9,600 )	\$ 1,350	\$ (865 )	\$ 485
Offsetting of Financial Liabilities:					
Derivatives(1)	\$5,948	\$ (5,312 )	\$ 636	\$ (588 )	\$ 48
Securities sold under agreement to repurchase	8,400	0	8,400	(8,400 )	0
Total liabilities	\$14,348	\$ (5,312 )	\$ 9,036	\$ (8,988 )	\$ 48

(1) Amounts exclude the excess of collateral received/pledged from/to the counterparty.

For information regarding the rights of offset associated with the derivative assets and liabilities in the table above, see “—Counterparty Credit Risk” below. For securities purchased under agreements to resell and securities sold under agreements to repurchase, the Company monitors the value of the securities and maintains collateral, as appropriate, to



protect against credit exposure. Where the Company has entered into repurchase and resale agreements with the same counterparty, in the event of default, the Company would generally be permitted to exercise rights of offset. For additional information on the Company's accounting policy for securities repurchase and resale agreements, see Note 2 to the Company's Consolidated Financial Statements included in the Annual Report on Form 10-K for the year ended December 31, 2017.

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

## Cash Flow, Fair Value and Net Investment Hedges

The primary derivative instruments used by the Company in its fair value, cash flow and net investment hedge accounting relationships are interest rate swaps, currency swaps and currency forwards. These instruments are only designated for hedge accounting in instances where the appropriate criteria are met. The Company does not use futures, options, credit, equity or embedded derivatives in any of its fair value, cash flow or net investment hedge accounting relationships.

The following table provides the financial statement classification and impact of derivatives used in qualifying and non-qualifying hedge relationships, excluding the offset of the hedged item in an effective hedge relationship.

Three Months Ended June 30, 2018

	Realized Investment Gains (Losses)	Net Investment Income	Other Income	Interest Expense	Interest Credited To Policyholders' Account Balances	AOCI(1)
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(in millions)

## Derivatives Designated as Hedge Accounting Instruments:

## Fair value hedges

Interest Rate	\$5	\$ (2 )	\$ 0	\$ 0	\$ (28 )	\$ 0
Currency	1	0	0	0	0	0
Total fair value hedges	6	(2 )	0	0	(28 )	0

## Cash flow hedges

Interest Rate	0	0	0	0	0	(1 )
Currency	0	0	0	0	0	18
Currency/Interest Rate	0	52	209	0	0	704
Total cash flow hedges	0	52	209	0	0	721

## Net investment hedges

Currency	2	0	0	0	0	5
Currency/Interest Rate	0	0	0	0	0	0
Total net investment hedges	2	0	0	0	0	5

## Derivatives Not Qualifying as Hedge Accounting

## Instruments:

Interest Rate	(432 )	0	0	0	0	0
Currency	(130 )	0	(1 )	0	0	0
Currency/Interest Rate	606	0	2	0	0	0
Credit	(1 )	0	0	0	0	0
Equity	(258 )	0	0	0	0	0
Other	(1 )	0	0	0	0	0
Embedded Derivatives	658	0	0	0	0	0
Total non-qualifying hedges	442	0	1	0	0	0
Total	\$450	\$ 50	\$ 210	\$ 0	\$ (28 )	\$ 726

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Six Months Ended June 30, 2018					
	Realized	Net	Other	Interest	Interest	
	Investment	Investment	Income	Expense	Credited to	
	Gains	Income			Policyholders' AOCI(1)	
	(Losses)				Account	
					Balances	
	(in millions)					
Derivatives Designated as Hedge Accounting Instruments:						
Fair value hedges						
Interest Rate	\$22	\$ (6 )	\$ 0	\$ 0	\$ (111 )	\$ 0
Currency	3	0	0	0	0	0
Total fair value hedges	25	(6 )	0	0	(111 )	0
Cash flow hedges						
Interest Rate	0	0	0	(1 )	0	6
Currency	0	0	0	0	0	9
Currency/Interest Rate	0	100	118	0	0	123
Total cash flow hedges	0	100	118	(1 )	0	138
Net investment hedges						
Currency	0	0	0	0	0	3
Currency/Interest Rate	0	0	0	0	0	0
Total net investment hedges	0	0	0	0	0	3
Derivatives Not Qualifying as Hedge Accounting Instruments:						
Interest Rate	(1,947)	0	0	0	0	0
Currency	279	0	0	0	0	0
Currency/Interest Rate	52	0	1	0	0	0
Credit	(5 )	0	0	0	0	0
Equity	(248 )	0	0	0	0	0
Other	(1 )	0	0	0	0	0
Embedded Derivatives	2,637	0	0	0	0	0
Total non-qualifying hedges	767	0	1	0	0	0
Total	\$792	\$ 94	\$ 119	\$ (1 )	\$ (111 )	\$ 141

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Three Months Ended June 30, 2017

	Realized Investment Gains (Losses)	Net Investment Income	Other Income	Interest Expense	Interest Credited To Policyholders Account Balances	AOCI(1)
(in millions)						
<b>Derivatives Designated as Hedge Accounting</b>						
<b>Instruments:</b>						
<b>Fair value hedges</b>						
Interest Rate	\$0	\$ (5 )	\$0	\$ 0	\$ 0	\$ 0
Currency	(5 )	0	0	0	0	0
Total fair value hedges	(5 )	(5 )	0	0	0	0
<b>Cash flow hedges</b>						
Interest Rate	0	0	0	(1 )	0	1
Currency/Interest Rate	0	49	(125 )	0	0	(340 )
Total cash flow hedges	0	49	(125 )	(1 )	0	(339 )
<b>Net investment hedges</b>						
Currency	0	0	0	0	0	(3 )
Currency/Interest Rate	0	0	0	0	0	0
Total net investment hedges	0	0	0	0	0	(3 )
<b>Derivatives Not Qualifying as Hedge Accounting</b>						
<b>Instruments:</b>						
Interest Rate	1,110	0	0	0	0	0
Currency	(46 )	0	(2 )	0	0	0
Currency/Interest Rate	(53 )	0	0	0	0	0
Credit	6	0	0	0	0	0
Equity	(453 )	0	0	0	0	0
Other	0	0	0	0	0	0
Embedded Derivatives	(2,059 )	0	0	0	0	0
Total non-qualifying hedges	(1,495 )	0	(2 )	0	0	0
Total	\$(1,500)	\$ 44	\$(127)			