Recon Technology, Ltd
Form PRER14A
May 02, 2016

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934

Amendment No. 1

Filed by the Registrant x

Filed by a Party other than the Registrant ¨
Check the appropriate box:

x Preliminary Proxy Statement
¨ Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
¨ Definitive Proxy Statement
¨ Definitive Additional Materials
¨ Soliciting Material Pursuant to Rule 14a-12

RECON TECHNOLOGY, LTD

(Name of Registrant as Specified in Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

¨ No fee required.

x Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies: ordinary shares, par value $0.0185 per share

(2) Aggregate number of securities to which transaction applies: 2,686,567

(3)

Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined): The aggregate value was determined as follows: (i) 2,686,567 ordinary shares of the Company multiplied by $1.34 per share and (ii) a cash payment of up to $4.8 million. In accordance with Section 14(g) of the Securities Exchanges Act of 1934, as amended, the filing fee was determined by multiplying 0.0001007 by the sum calculated in the preceding sentence.

(4) Proposed maximum aggregate value of transaction: $8,399,999

(5) Total fee paid: $845.88

¨ Fee paid previously with preliminary materials.

¨ Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

EXPLANATORY NOTE

This Amendment No. 1 to Schedule 14A (“Amendment No. 1”) is being filed to amend the preliminary proxy statement (“Proxy Statement”) of Recon Technology, Ltd (the “Company“) for its 2016 Annual Meeting of Stockholders of the Company (the “Meeting”) which was filed with the Securities and Exchange Commission on February 16, 2016 in order to (i) provide further background regarding Chen Guangqiang’s relationship with Qinghai Hua You Downhole Technology Co., Ltd., a P.R. China limited liability company (“QHHY”), (ii) provide further background on the anticipated accounting treatment of the Transactions (as defined in the Proxy Statement) and (iii) provide updated interim financial statements for QHHY.

RECON TECHNOLOGY, LTD

Room 1902, Building C, King Long International Mansion

No. 9 Fulin Road, Beijing 100107

People's Republic of China

Notice of 2015 Annual Meeting of Stockholders

To Be Held on [*], 2016

To the Stockholders:

Recon Technology, Ltd. (the "Company," or "we") will hold the 2015 annual meeting of stockholders (the "Annual Meeting") on [*], 2016 at 9:00 a.m., Eastern Time, at Room 1902, King Long International Mansion, 9 Fulin Road, Beijing, China, for the following purposes:

1. To elect two Class III members of the board of directors, to serve a term expiring at the Annual Meeting following the fiscal year ending June 30, 2018, or until his successor is duly elected and qualified;

2. To ratify the appointment of Friedman LLP as the Company's independent registered public accounting firm for the fiscal year ending June 30, 2016;
3. To approve and adopt the Share Purchase Agreement, dated as of December 1, 2015 (as it may be amended from time to time) (the "Share Purchase Agreement"), by and between the Company, Qinghai Hua You Downhole Technology Co., Ltd., a P.R. China limited liability company ("QHHY"), the shareholders of QHHY ("QHHY Shareholders"), and Recon Hengda Technology (Beijing) Co., Ltd., the Company's wholly owned P.R. China subsidiary ("Recon BJ"), a copy of which is attached as Annex A to this proxy statement, pursuant to which the Company will issue 2,686,567 ordinary shares and make a cash payment of up to $4.8 million to the QHHY Shareholders in exchange for the control and eventual acquisition of QHHY by Recon BJ through a series of agreements, including an exclusive equity interest purchase agreement, an equity interest pledge agreement, an

exclusive technical consulting and service agreement and powers of attorney for each of the QHHY Shareholders (collectively, the “Control Agreements” and, together with the Share Purchase Agreement, the “Transactions”), which are attached as appendices to the Share Purchase Agreement;

4. To approve the issuance of an aggregate of 2,686,567 ordinary shares of the Company to QHHY Shareholders pursuant to the Share Purchase Agreement;
5. To approve the adjournment of the Annual Meeting for any purpose, including to solicit additional proxies if there are insufficient votes at the time of the Annual Meeting to approve the proposal described above; and
6. To transact any other business as may properly come before the meeting.

The foregoing items of business are more completely described in the proxy statement accompanying this notice. The board of directors has determined that the Share Purchase Agreement and the Transactions contemplated thereunder are advisable and in the best interests of the Company and its stockholders and has unanimously approved the other proposals described herein**.** The board of directors unanimously recommends that the stockholders vote “FOR” the proposal to approve and adopt the Share Purchase Agreement, vote “FOR” the proposal to approve the issuance of the ordinary shares of the Company pursuant to the Share Purchase Agreement and vote “FOR” the proposal to adjourn the Annual Meeting for any purpose, including to solicit additional proxies if there are insufficient votes at the time of the Annual Meeting to approve and adopt the proposals described above.

The board of directors has established the close of business on [*] as the “record date” that will determine the stockholders who are entitled to receive notice of, and to vote at, the Annual Meeting or at any adjournment or postponement of the Annual Meeting. The notice of the Annual Meeting, this proxy statement, the proxy card and a copy of our 2015 Annual Report on Form 10-K will be first sent or made available to stockholders on or before [*], 2016.

Attendance at the Annual Meeting is limited to the Company’s stockholders, their proxies and invited guests of the Company.

By order of the Board of Directors,

/s/ Yin Shenping
Yin Shenping,
Chairman and Chief Executive Officer

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QUESTIONS AND ANSWERS ABOUT THE ANNUAL MEETING AND THE ACQUISITION

The following questions and answers are intended to address briefly some commonly asked questions regarding the Annual Meeting, the Share Purchase Agreement, the related Control Agreements contemplated thereunder, and the stockholder meeting in general. These questions and answers may not address all of the questions that may be important to you as a stockholder. To better understand these matters, and for a description of the legal terms governing the Transactions, you should carefully read this entire proxy statement, including the annexes thereto.

Q: Why am I receiving this proxy statement?

A: The Company is holding its Annual Meeting to elect two Class III directors, ratify the appointment of the Company's auditiors, and approve the Company's entrance into a Share Purchase Agreement with Recon BJ, QHHY and the QHHY Shareholders pursuant to which the Company will issue an aggregate of 2,686,567 ordinary shares and make a cash payment of up to $4.8 million to the QHHY Shareholders in exchange for the control and eventual acquisition (upon receipt of certain government approval) of QHHY through a series of agreements, including an exclusive equity interest purchase agreement, an equity interest pledge agreement, an exclusive technical consulting and service agreement, and powers of attorney for each of the QHHY Shareholders (collectively, the "Control Agreements"), which are attached as appendices to the Share Purchase Agreement (the Control Agreements and Share Purchase Agreement, hereinafter referred to as the "Transactions"). A copy of the Share Purchase Agreement is included as Annex A to this proxy statement. In order to complete the Transactions, among other things, the stockholders must approve the Share Purchase Agreement and the Control Agreements, including the issuance of 2,686,567 ordinary shares of the Company and the payment of up to $4.8 million in cash for Recon BJ's control and eventual acquisition of QHHY.

We have included in this proxy statement important information about the Transactions and the Annual Meeting. You should read this information carefully and in its entirety. The enclosed voting materials allow you to vote your shares without attending the applicable stockholder meeting. Your vote is very important and we encourage you to submit your proxy as soon as possible.

Q: What proposals are the stockholders being asked to consider?

A: The stockholders are being asked to:

1. elect two Class III members of the board of directors, to serve a term expiring at the Annual Meeting of Shareholders following the fiscal year ending June 30, 2018, or until his successor is duly elected and qualified;

2. ratify the appointment of Friedman LLP as the Company's independent registered public accounting firm for the fiscal year ending June 30, 2016;

3. approve and adopt the Share Purchase Agreement, a copy of which is attached as Annex A to this proxy statement, and the Transactions contemplated thereby;

4. approve the issuance of 2,686,567 ordinary shares of the Company to QHHY Shareholders pursuant to the Share Purchase Agreement;

5. approve the adjournment of the Annual Meeting for any purpose, including to solicit additional proxies if there are insufficient votes at the time of the Annual Meeting to approve the proposals described above; and

6. transact any other business properly coming before the meeting.

Q: What are the recommendations of the boards of directors?

A: The board of directors has approved the Share Purchase Agreement and the Transactions contemplated thereby and determined that the Share Purchase Agreement and the Transactions are advisable and in the best interests of the stockholders.

THE BOARD OF DIRECTORS HAS DETERMINED THAT THE ELECTION OF TWO CLASS III MEMBERS OF THE BOARD OF DIRECTORS, THE RATIFICATION OF THE APPOINTMENT OF THE COMPANY'S FIRM AUDITORS AND SHARE PURCHASE AGREEMENT AND THE TRANSACTIONS CONTEMPLATED THEREUNDER ARE ADVISABLE AND IN THE BEST INTERESTS OF THE COMPANY AND ITS STOCKHOLDERS AND HAS UNANIMOUSLY APPROVED THE OTHER PROPOSALS DESCRIBED HEREIN. THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT THE STOCKHOLDERS VOTE "FOR" THE ELECTION OF DIRECTORS, "FOR" THE RATIFICATION OF THE APPOINTMENT OF THE COMPANY'S AUDITORS, VOTE "FOR" THE PROPOSAL TO APPROVE AND ADOPT THE SHARE PURCHASE AGREEMENT, VOTE "FOR" THE PROPOSAL TO APPROVE THE ISSUANCE OF THE ORDINARY SHARES OF THE COMPANY PURSUANT TO THE SHARE PURCHASE AGREEMENT AND VOTE "FOR" THE PROPOSAL TO ADJOURN THE ANNUAL MEETING FOR ANY PURPOSE, INCLUDING TO SOLICIT ADDITIONAL PROXIES IF THERE ARE INSUFFICIENT VOTES AT THE TIME OF THE ANNUAL MEETING TO APPROVE AND ADOPT THE PROPOSALS DESCRIBED ABOVE.

Q: When and where will the Annual Meeting be held?

A: The Annual Meeting of stockholders will be held [*], 2016 at 9:00 a.m., Beijing Time, at Room 1902, King Long International Mansion, 9 Fulin Road, Beijing, China.

Q: Who is entitled to vote at the Annual Meeting?

A: The record date for the Annual Meeting is [*], 2016. Only holders of ordinary shares of the Company as of the close of business on the record date are entitled to notice of, and to vote at, the Annual Meeting or any adjournment or postponement thereof. As of the record date there were [*] ordinary shares outstanding.

Q: What constitutes a quorum for the Annual Meeting?

A: At the Annual Meeting, the presence in person or by proxy of one-third (1/3) of our outstanding ordinary shares as of the record date will constitute a quorum at such Annual Meeting. Abstentions and broker non-votes will be counted for purposes of establishing a quorum at the meeting.

Q: How many votes are required to approve the proposals?

A: *Nomination of Class III Directors*: The nominees receiving the highest number of "For" votes will be elected as a directors. This number is called a plurality. Shares not voted will have no impact on the election of directors. The proxy given will be voted "For" the nominee for director unless a properly executed proxy card is marked "Withhold" as to the nominee for director.

Ratification of Appointment of Auditors: The ratification of the appointment of Friedman LLP as the Company's independent registered public accounting firm for the fiscal year ending June 30, 2016 requires that a majority of the votes cast at the meeting be voted "For" the proposal. A properly executed proxy card marked "Abstain" with respect to this proposal will not be voted.

Proposal to Approve and Adopt the Share Purchase Agreement: If a quorum is present, the approval and adoption of the Share Purchase Agreement, and the Transactions contemplated thereby, will require the affirmative vote of a majority of the shares present in person or represented by proxy at a duly called meeting.

Proposal to Issue Ordinary Shares Pursuant to the Share Purchase Agreement: If a quorum is present, the approval of the issuance of ordinary shares pursuant to the Share Purchase Agreement requires the affirmative vote of a majority of the shares present in person or represented by proxy at a duly called meeting.

Proposal to Adjourn the Annual Meeting: If a quorum is present, the Annual Meeting may be adjourned by the affirmative vote of a majority of the shares present in person or represented by proxy at a duly called meeting.

Q: Is cumulative voting permitted for the election of directors?

A: No. You may not cumulate your votes for the election of directors.

Q: How do the stockholders vote?

A: The stockholders have four voting options. You may vote using one of the following methods:

- *Internet*. You can vote over the Internet by accessing the website at *www.proxyvote.com*, and following the instructions on the website. Internet voting is available 24 hours a day. If you vote over the Internet, do not return your proxy card.
- *Telephone*. If you hold shares directly in your own name and are the holder of record, you can vote by telephone by calling the toll-free number 1-800-690-6903 in the United States, Canada or Puerto Rico on a touch-tone phone. You will then be prompted to enter the control number printed on your proxy card and to follow the subsequent instructions. Telephone voting is available 24 hours a day. If, however, you hold the shares through a broker ("street name") and not in your own name, then follow the specific instructions included in your proxy materials, including the specific phone number to use, to vote your shares by phone.

- *Mail*. You can vote by mail by simply completing, signing, dating and mailing your proxy card in the postage-paid envelope included with this proxy statement.
- *In Person*. You may also come to the Annual Meeting and cast your vote there. The board of directors recommends that you vote by proxy even if you plan to attend the meeting. If your shares are held in a stock brokerage account or through a bank, broker or other nominee, or, in other words, in street name, and you wish to vote in person at the meeting, you must bring a letter from your bank, broker or nominee identifying you as the beneficial owner of the shares and authorizing you to vote such shares at the meeting.

Q: How can I attend the meeting?

A: The meeting is open to all holders of the Company's ordinary shares as of the record date. You may attend the meeting in person or at the Internet location listed on your proxy card. In addition, you may call in to the conference call for the meeting. The dial-in number in the United States is 1-866-620-9467, and the dial-in number in China is 010-95057. The password for the meeting is 97399962. Shareholders living in other countries are welcome to attend the conference call by contacting our Company at info@recon.cn.

Q: May stockholders ask questions at the meeting?

A: Yes. Representatives of the Company will answer questions of general interest at the end of the meeting. In addition, a representative of Friedman LLP, our independent registered public accounting firm, is expected to be present at the Annual Meeting and will be allowed the opportunity to make a statement if desired and respond to appropriate questions.

Q: If my shares are held in "street name" by a broker or other nominee, will my broker or nominee vote my shares for me?

A: Your broker or other nominee does not have authority to vote on non-routine matters. All of the proposals presented at the Annual meeting are considered non-routine matters. Your broker or other nominee will vote your shares held by it in "street name" with respect to these matters only if you provide instructions to it on how to vote. You should follow the directions your broker or other nominee provides.

Q: What if I do not vote on the matters relating to the proposals?

A: If you fail to vote or fail to instruct your broker or other nominee how to vote on any of the proposals, it will have no effect on such proposals. It will be treated as a "non-vote" and not count toward a quorum.

Q: May I change my vote after I have delivered my proxy or voting instruction card?

A: Yes. You may change your vote at any time before your proxy is voted at the Annual meeting. You may do this in one of four ways:

- by sending a notice of revocation to the corporate secretary of the Company, dated as of a later date than the date of the proxy and received prior to the Annual Meeting;
- by sending a completed proxy card bearing a later date than your original proxy card and mailing it so that it is received prior to the Annual Meeting;
- by logging on to the Internet website specified on your proxy card in the same manner you would to submit your proxy electronically or by calling the telephone number specified on your proxy card, in each case if you are eligible to do so and following the instructions on the proxy card; or
- by attending your annual or Annual Meeting, as applicable, and voting in person.

Your attendance alone will not revoke any proxy.

If your shares are held in an account at a broker or other nominee, you should contact your broker or other nominee to change your vote.

Q: Do I have appraisal rights?

A: The stockholders do not have appraisal rights with respect to the matters to be voted upon at the Annual Meeting.

Q: Whom should I call if I have questions about the proxy materials or voting procedures?

A: If you have questions about the proposals, or if you need assistance in submitting your proxy or voting your shares or need additional copies of this proxy statement or the enclosed proxy card, you should contact Recon Technology Ltd., Room 1902, Building C, King Long International Mansion, No. 9 Fulin Road, Beijing 100107, People's Republic of China. If your shares are held in a stock brokerage account or by a bank or other nominee, you should contact your broker, bank or other nominee for additional information.

Q: What do I need to do now?

A: After carefully reading and considering the information contained in this proxy statement, including the annexes, please vote your shares as soon as possible so that your shares will be represented at the Annual Meeting. Please follow the instructions set forth on the proxy card or on the voting instruction form provided by the record holder if your shares are held in the name of your broker or other nominee.

Q: Who is paying for the expenses involved in preparing and mailing this proxy statement?

A: All of the expenses involved in preparing, assembling and mailing these proxy materials and all costs of soliciting proxies will be paid for by the Company. In addition to the solicitation by mail, proxies may be solicited by our officers and other employees by telephone or in person. Such persons will receive no compensation for their services other than their regular salaries. Arrangements will also be made with brokerage houses and other custodians, nominees and fiduciaries to forward solicitation materials to the beneficial owners of the shares held of record by such persons, and we may reimburse such persons for reasonable out of pocket expenses incurred by them in so doing.

Q: What Interest Do Officers and Directors Have in Matters to Be Acted Upon?

A: Members of the board of directors and executive officers of the Company do not have any interest in any other proposal that is not shared by all other stockholders of the Company, other than Proposal 1, the election to our board of the two nominees set forth herein.

Mr. Chen, our Chief Technology Officer and a director nominee, was a founder and prior shareholder of QHHY and has participated in the negotiations relating to the Share Purchase Agreement and Transactions. See “Summary of Information Related to Proposal 3 and Proposal 4—Interests of Directors and Executive Officers in the Transactions.”

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PROPOSAL 1

ELECTION OF DIRECTORS

(ITEM 1 ON THE PROXY CARD)

Director Biographies

A brief biography of each director in each Class follows. You are asked to vote for two nominees to serve as Class III members of the board of directors. The candidates for the board of directors have consented to serve if elected. The terms of the Class II members of the board of directors continue until the Annual Meeting of Stockholders following the fiscal year ending June 30, 2017 and the terms of the Class I member of the board of directors continues until the Annual Meeting of Stockholders following the fiscal year ending June 30, 2016.

Nominees for election as Class III members of the board of directors to serve for three-year terms, whose terms continue until the Annual Meeting of Stockholders following the fiscal year ending June 30, 2018:

Yin Shenping
Chief Executive Officer and Director Nominee
Age – 46

Director since 2007

In 2003, Mr. Yin founded Nanjing Recon, a Chinese company that provides services to automate and enhance the extraction of petroleum in the PRC, and has been the Chief Executive Officer since that time. Prior to founding Nanjing Recon, Mr. Yin served as a sales manager for Fujian Haitian Network Company from 1992 through 1994. Mr. Yin has founded and operated a number of companies: Xiamen Hengda Haitian Computer Network Co., Ltd. (1994), Baotou Hengda Haitian Computer Network Co., Ltd. (1997) and Beijing Jingke Haitian Electronic Technology Development Co., Ltd. (1999), and Jingsu Huasheng Information Technology Co., Ltd. (2000). In 2000, Mr. Yin merged the former Nanjing Kingsley Software Engineering Co., Ltd. into Nanjing Recon. Mr. Yin received his bachelor’s degree in 1991 from Nanjing Agricultural University in information systems. Mr. Yin was chosen as a director, and serves as Chairman of the board, because he is one of the founders of our company and we believe his knowledge of our company and years of experience in our industry give him the ability to guide our company as a director.

Chen Guangqiang
Chief Technology Officer and Director Nominee
Age – 52

Director since 2007

Mr. Chen has served as our Chief Technology Officer since 2003. Mr. Chen was a geological engineer for the Fourth Oil Extraction Plant of Huabei Oil Field from 1985 through 1993. From 1993 through 1999, Mr. Chen was a chief engineer for Xinda Company, CNPC Development Bureau. From 1999 through 2003, Mr. Chen served as the general manager of Beijing Adar. From 2011 to March 2013, Mr. Chen was a founder and majority shareholder of QHHY. From March 2013 to December 2014, Mr. Chen remained a 40% shareholder of QHHY but was no longer involved QHHY's day to day operations. Mr. Chen received his bachelor's degree in 1985 from Southwest Petroleum Institute. Mr. Chen was chosen as a director because he is one of the founders of our company and we believe we can benefit from his years of engineering and management experience in the oil extraction industry.

Class II members of the board of directors, whose terms continue until the Annual Meeting of Stockholders following the fiscal year ending June 30, 2017:

Hu Jijun
Independent Director
Age – 50

Director since 2008

Mr. Hu joined our Board of Directors in 2008. From 1988 to 2003, Mr. Hu served in a variety of positions at our No. 2 test-drill plant, including technician of installation, assets equipment work, electrical installation, control room production dispatcher, Deputy Chief Engineer of the Technology Battalion and Deputy Director of Production. From 2003 to 2005, Mr. Hu served as Head of the Integrated Battalion and he is currently the Head of the Transport Battalion, Senior Electric Engineer. Mr. Hu graduated as an automated professional from the China University of Petroleum in 1988. Mr. Hu was chosen as a director because we believe his years of experience and knowledge gained while working at our No. 2 test-drill plant will prove beneficial to the guidance of our company.

Nelson N.S. Wong

Independent Director

Age – 53

Director since 2008

Mr. Wong joined our board of directors in 2008. In 1990 Mr. Wong joined the Vigers Group, a real estate company that provides services in valuation, corporate property services, investment advisory services, general practice surveying, building surveying, commercial, retail and industrial agency, and property and facilities management. Mr. Wong became the Vice Chairman and CEO of the Vigers Group in 1993. In 1995 Mr. Wong established the ACN Group, a business consulting firm, where he has worked continuously and continues to serve as the Chairman and Managing Partner. Mr. Wong received a bachelor's degree in arts from the PLA Institute of International Relations in Nanjing in 1983. Mr. Wong was chosen as a director because we believe we can benefit from his leadership skills and management experience.

Class I member of the board of directors, whose term continues until to the Annual Meeting of Stockholders following the fiscal year ending June 30, 2016:

Zhao Shudong

Independent Director

Age – 69

Before retiring in 2006, Mr. Zhao spent over 30 years working in the oilfield industry. From 1970 to 1976, Mr. Zhao worked as a technician in the Daqing oilfield. From 1976 to 1982, Mr. Zhao served as the vice director of the Hubei Oilfield Generalized Geologic Technical Research Institute. Mr. Zhao then spent 11 years as a director and section chief at the Scientific and Technological Development Department of the Huabei Petroleum Administrative Bureau. He was subsequently appointed Chief Geologist of the bureau, a position he held from 1993 to 1999. From 1999 to 2006, Mr. Zhao served as the General Manager of the Huabei Oilfield Company of CNPC. Mr. Zhao studied at the Northeast Petroleum Institute from 1965 to 1970. Mr. Zhao was chosen as a director because of his extensive experience in the oilfield industry.

Involvement in Certain Legal Proceedings

To the best of our knowledge, none of our directors or executive officers has been convicted in a criminal proceeding, excluding traffic violations or similar misdemeanors, or has been a party to any judicial or administrative proceeding during the past ten years that resulted in a judgment, decree or final order enjoining the person from future violations of, or prohibiting activities subject to, federal or state securities laws, or a finding of any violation of federal or state securities or commodities laws, any laws respecting financial institutions or insurance companies, any law or regulation prohibiting mail or wire fraud in connection with any business entity or been subject to any disciplinary sanctions or orders imposed by a stock, commodities or derivatives exchange or other self-regulatory organization, except for matters that were dismissed without sanction or settlement. None of our directors, director nominees or executive officers has been involved in any transactions with us or any of our directors, executive officers, affiliates or associates which are required to be disclosed pursuant to the rules and regulations of the SEC.

Family Relationships

There are no family relationships among any of our directors or executive officers.

Leadership Structure of the Board of Directors

Mr. Yin Shenping currently holds both the positions of Chief Executive Officer and Chairman of the board of directors. The board of directors believes that Mr. Yin's service as both Chief Executive Officer and Chairman of the board of directors is in the best interests of the Company and its shareholders. Mr. Yin possesses detailed and in-depth knowledge of the issues, opportunities and challenges facing the Company and its business and is thus best positioned to develop agendas that ensure that the board's time and attention are focused on the most critical matters. His combined role enables decisive leadership, ensures clear accountability, and enhances the Company's ability to communicate its message and strategy clearly and consistently to the Company's stockholders, employees, customers and suppliers.

We do not have a lead independent director because of the foregoing reasons and also because we believe our independent directors are encouraged to freely voice their opinions on a relatively small company board. We believe this leadership structure is appropriate because we are a smaller reporting company that recently became listed on a public exchange; as such, we deem it appropriate to be able to benefit from the guidance of Mr. Yin as both our Chief Executive Officer and Chairman of the board of directors.

Risk Oversight

Our board of directors plays a significant role in our risk oversight. The board of directors makes all relevant Company decisions. As such, it is important for us to have our Chief Executive Officer serve on the board as he plays a key role in the risk oversight of the Company. As a smaller reporting company with a small board of directors, we believe it is appropriate to have the involvement and input of all of our directors in risk oversight matters.

There are no material proceedings to which any director, officer or affiliate of the Company, any owner of record or beneficially of more than 5% of the Company's shares of common stock, or any associate of such persons is a party adverse to Company or has a material interest adverse to the Company.

WE RECOMMEND THAT YOU VOTE FOR THE ELECTION OF THE CLASS III NOMINEES TO THE BOARD OF DIRECTORS.

BOARD OF DIRECTORS AND CORPORATE GOVERNANCE INFORMATION

What if a nominee is unwilling or unable to serve?

The two nominees listed in the Proxy Statement have agreed to serve as directors, if elected. If for some unforeseen reason either nominee becomes unwilling or unable to serve, proxies will be voted for a substitute nominee selected by the board of directors.

How are directors compensated?

All directors hold office until the expiration of their respective terms and until their successors have been duly elected and qualified. There are no family relationships among our directors or executive officers. Officers are elected by and serve at the discretion of the board of directors. Employee directors and non-voting observers do not receive any compensation for their services. Non-employee directors are entitled to receive $2,000 per each board of directors meeting attended. In addition, non-employee directors are entitled to receive compensation for their actual travel expenses for each board of directors meeting attended.

Summary Director Compensation Table

Name(1)	Fees earned or paid in cash	Option Awards	Total(2)
Nelson N.S. Wong	$ 8,000	$ 5,728	$ 13,728
Hu Jijun	$ 8,000	$ 5,728	$ 13,728
Zhao Shudong	$ 8,000	$ 4,124	$ 12,124

(1)

Compensation for our directors Yin Shenping and Chen Guangqiang, who also serve as executive officers, is fully disclosed in the executive compensation discussion on pages 15-16 of this Proxy Statement.

(2) None of the directors received any ordinary share awards, nonqualified deferred compensation earnings or non-equity incentive plan compensation in fiscal year 2015.

(3) On January 31, 2015, the Company granted 25,000 options to Mr. Nelson N.S. Wong, which options vest over a period of three years, one third of which vest on January 31 of each year beginning in 2016. The grant date fair value of such options was $1.65.

(4) On January 31, 2015, the Company granted 25,000 options to Mr. Hu Jijun, which options vest over a period of three years, one third of which vest on January 31 of each year beginning in 2016. The grant date fair value of such options was $1.65.

(5) On January 31, 2015, the Company granted 18,000 options to Zhao Shudong, which options vest over a period of three years, one third of which vest on January 31 of each year beginning in 2016. The grant date fair value of such options was $1.65.

How does the Board of Directors determine which directors are independent?

The board of directors reviews the independence of each director yearly. During this review, the board of directors considers transactions and relationships between each director (and his or her immediate family and affiliates) and the Company and its management to determine whether any such relationships or transactions are inconsistent with a determination that the director is independent in light of applicable law, listing standards and the Company’s director independence standards. The Company believes that it maintains a majority of independent directors who are deemed to be independent under the definition of independence provided by NASDAQ Listing Rule 5605(a)(2).

What role does the Nominating Committee play in selecting nominees to the board of directors?

Two of the primary purposes of the Nominating Committee of the board of directors are (i) to develop and implement policies and procedures that are intended to ensure that the board of directors will be appropriately constituted and organized to meet its fiduciary obligations to the Company and its shareholders and (ii) to identify individuals qualified to become members of the board of directors and to recommend to the board of directors the director nominees for the annual meeting of shareholders. The Nominating Committee is also responsible for considering candidates for membership on the board of directors submitted by eligible shareholders. The Nominating Committee's charter is available on the Company's website at www.recon.cn under Investor Relations and in print upon request. The Nominating Committee of the Company's board of directors was the only entity or person to nominate and/or recommend any of the director nominees.

Are the members of the Nominating Committee independent?

Yes. All members of the Nominating Committee have been determined to be independent by the board of directors.

How does the Nominating Committee identify and evaluate nominees for director?

The Nominating Committee considers candidates for nomination to the board of directors from a number of sources. Current members of the board of directors are considered for re-election unless they have notified the Company that they do not wish to stand for re-election. The Nominating Committee also considers candidates recommended by current members of the board of directors, members of management or eligible shareholders. From time to time the Board may engage a firm to assist in identifying potential candidates, although the Company did not engage such a firm to identify any of the nominees for director proposed for election at the meeting.

The Nominating Committee evaluates all candidates for director, regardless of the person or firm recommending such candidate, on the basis of the length and quality of their business experience, the applicability of such candidate's experience to the Company and its business, the skills and perspectives such candidate would bring to the board of directors and the personality or "fit" of such candidate with existing members of the board of directors and management. The nominating committee does not have a specific policy in place with regard to the consideration of diversity when identifying director nominees, however, the nominating committee does consider diversity of opinion and experience when nominating directors.

What are the Nominating Committee's policies and procedures for considering director candidates recommended by stockholders?

The Nominating Committee will consider all candidates recommended by stockholders. A shareholder wishing to recommend a candidate must submit the following documents to the Secretary of the Company at Recon Technology, Ltd, Room 1902, Building C, King Long International Mansion, 9 Fulin Road, Beijing 100107 China:

- a recommendation that identifies the name and address of the shareholder and the person to be nominated;
- the written consent of the candidate to serve as a director of the Company, if elected;
- a description of all arrangements between the stockholders and such nominee pursuant to which the nomination is to be made; and
- such other information regarding the nominee as would be required to be included in a proxy statement filed pursuant to the proxy rules of the SEC.

If the candidate is to be evaluated by the Nominating Committee, the Secretary will request a detailed resume, an autobiographical statement explaining the candidate's interest in serving as a director of the Company, a completed statement regarding conflicts of interest, and a waiver of liability for a background check from the candidate.

What are the minimum qualifications required to serve on the Company's board of directors?

All members of the board of directors must possess the following minimum qualifications as determined by the Nominating Committee:

- A director must demonstrate integrity, accountability, informed judgment, financial literacy, creativity and vision;
- A director must be prepared to represent the best interests of all Company shareholders, and not just one particular constituency;
- A director must have a record of professional accomplishment in his or her chosen field; and
- A director must be prepared and able to participate fully in board activities, including membership on committees.

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What other considerations does the Nominating Committee consider?

The Nominating Committee believes it is important to have directors from various backgrounds and professions in order to ensure that the board of directors has a wealth of experiences to inform its decisions. Consistent with this philosophy, in addition to the minimum standards set forth above, business and managerial experience and an understanding of financial statements and financial matters are very important.

How may stockholders communicate with the members of the board of directors?

Stockholders and others who are interested in communicating directly with members of the board of directors, including communication of concerns relating to accounting, internal accounting controls or audit matters, or fraud or unethical behavior, may do so by writing to the directors at the following address:

Name of Director or Directors
c/o Secretary
Recon Technology, Ltd.
Room 1902, Building C

King Long International Mansion

9 Fulin Road

Beijing 100107 China

Does the Company have a Code of Business Ethics and Conduct?

The Company has adopted a Code of Business Ethics and Conduct, which is applicable to all directors, officers and associates of the Company, including the principal executive officer and the principal financial and accounting officer. The complete text of the Code of Business Ethics and Conduct is available on the Company’s web site at www.recon.cn and is also available in print upon request. The Company intends to post any amendments to or waivers from its Code of Business Ethics and Conduct (to the extent applicable to the Company’s principal executive officer and principal financial and accounting officer) at this location on its web site.

How often did the board of directors meet in fiscal 2015?

The board of directors met a total of five times, including one regularly scheduled meeting and four Annual Meetings, during fiscal 2015. The Compensation Committee, the Audit Committee and the Nominating Committee each met five times during fiscal 2015. The board of directors invites, but does not require, directors to attend the Annual Meeting of stockholders. All of our directors attended Company's last Annual Meeting of stockholders.

What are the committees of the board of directors?

During fiscal 2015, the board of directors had standing Audit, Nominating, and Compensation Committees. The members of each of the Committees as of April 25, 2016, their principal functions and the number of meetings held during the fiscal year ended June 30, 2015, are shown below.

Compensation Committee

The members of the Compensation Committee are:

Hu Jijun, Chairman

Nelson N.S. Wong

Zhao Shudong

The Compensation Committee held five meetings during the fiscal year ended June 30, 2015. The Compensation Committee's charter is available on the Company's website at www.recon.cn under Investor Relations and in print upon request. The Compensation Committee's principal responsibilities include:

- Making recommendations to the board of directors concerning executive management organization matters generally;
- In the area of compensation and benefits, making recommendations to the board of directors concerning employees who are also directors of the Company, consult with the CEO on matters relating to other executive officers, and make recommendations to the board of directors concerning policies and procedures relating to executive officers;
- Making recommendations to the board of directors regarding all contracts of the Company with any officer for remuneration and benefits after termination of regular employment of such officer;
- Making recommendations to the board of directors concerning policy matters relating to employee benefits and employee benefit plans, including incentive compensation plans and equity based plans; and
- Administering the Company's formal incentive compensation programs, including equity based plans.

The Compensation Committee may not delegate its authority to other persons. Similarly, the Compensation Committee has not engaged a compensation consultant to assist in the determination of executive compensation issues. While the Company's executives will communicate with the Compensation Committee regarding executive compensation issues, the Company's executive officers do not participate in any executive compensation decisions.

Audit Committee

The members of the Audit Committee are:

Nelson N.S. Wong, Chairman

Zhao Shudong

Hu Jijun

The Audit Committee held five meetings during the fiscal year ended June 30, 2015. The primary responsibility of the Audit Committee is to assist the board of directors in monitoring the integrity of the Company's financial statements and the independence of its external auditors. The Company believes that each of the members of the Audit Committee is "independent" and that Mr. Wong qualifies as an "audit committee financial expert" in accordance with applicable NASDAQ Capital Market listing standards. In carrying out its responsibility, the Audit Committee undertakes to:

- Review and recommend to the directors the independent auditors to be selected to audit the financial statements of the Company;

- Meet with the independent auditors and management of the Company to review the scope of the proposed audit for the current year and the audit procedures to be utilized, and at the conclusion thereof review such audit, including any comments or recommendations of the independent auditors;

- Review with the independent auditors and financial and accounting personnel the adequacy and effectiveness of the accounting and financial controls of the Company. The Audit Committee elicits recommendations for the improvement of internal control procedures or particular areas where new or more detailed controls or procedures are desirable. The Audit Committee emphasizes developing and maintaining the adequacy of such internal controls to expose any payments, transactions or procedures that might be deemed illegal or otherwise improper;

- Review the internal accounting functions of the Company, the proposed audit plans for the coming year and the coordination of such plans with the Company's independent auditors;

- Review the financial statements contained in the annual report to stockholders with management and the independent auditors to determine that the independent auditors are satisfied with the disclosure and contents of the financial statements to be presented to the stockholders;

- Provide sufficient opportunity for the independent auditors to meet with the members of the Audit Committee without members of management present. Among the items discussed in these meetings are the independent auditors' evaluation of the Company's financial, accounting, and auditing personnel, and the cooperation that the independent auditors received during the course of the audit;

- Review accounting and financial human resources and succession planning within the Company;

- Submit the minutes of all meetings of the Audit Committee to, or discuss the matters discussed at each committee meeting with, the Board of Directors; and

- Investigate any matter brought to its attention within the scope of its duties, with the power to retain outside counsel for this purpose, if, in its judgment, that is appropriate.

The Audit Committee has established procedures for the receipt, retention and treatment of complaints regarding accounting, internal accounting controls and auditing matters, including procedures for the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters.

Nominating Committee

The members of the Nominating Committee are:

Zhao Shudong, Chairman

Nelson N.S. Wong

Hu Jijun

The Nominating Committee had five meetings during the fiscal year ended June 30, 2015. All members of the Nominating Committee are independent, as such term is defined by the NASDAQ Capital Market listing standards. The Nominating Committee undertakes to:

- Identify individuals qualified to become members of the board of directors and to make recommendations to the board of directors with respect to candidates for nomination for election at the next annual meeting of shareholders or at such other times when candidates surface and, in connection therewith, consider suggestions submitted by shareholders of the Company;

- Determine and make recommendations to the board of directors with respect to the criteria to be used for selecting new members of the Board of Directors;

- Oversee the process of evaluation of the performance of the Company's board of directors and committees;

- Make recommendations to the board of directors concerning the membership of committees of the board and the chairpersons of the respective committees;

- Make recommendations to the board of directors with respect to the remuneration paid and benefits provided to members of the board in connection with their service on the board or on its committees; and

- Evaluate board and committee tenure policies as well as policies covering the retirement or resignation of incumbent directors.

The board of directors has determined to provide a process by which stockholders may communicate with the Board as a whole, a board committee or individual director. Stockholders wishing to communicate with the board as a whole, a board committee or an individual member may do so by sending a written communication addressed to the board of directors of the Company or to the committee or to an individual director, c/o Secretary, Recon Technology Ltd, Room 1902, Building C, King Long International Mansion, 9 Fulin Road, Beijing 100107 China. All communications will be compiled by the Secretary of the Company and submitted to the board of directors or the addressee not later than the next regular board meeting.

MANAGEMENT — BUSINESS HISTORY OF EXECUTIVE OFFICERS

For information as to the business history of our Chief Executive Officer, Mr. Yin, see the section “Proposal One: Election of Directors” elsewhere in this Proxy Statement.

Liu Jia

Chief Financial Officer

Age –33

Ms. Liu has served as our Chief Financial Officer since 2008. Prior to that, Ms. Liu assisted various companies, including Heilongjiang Province Jintian Group, with financial due diligence, field surveys and data analysis. While in college Ms. Liu served internships in Xinghua Certified Public Accountants, Ltd.; Beijing Zhongweihuahao Accountants Affairs Office; Tiantong Securities Co., Ltd. and Industrial and Commercial Bank of China, which internships focused on auditing, accounting and data analysis. Ms. Liu received her bachelor’s degree in 2006 from Beijing University of Chemical Technology, School of Economics and Management, and her master’s degree in industrial economics in 2009 from Beijing Wuzi University.

EMPLOYMENT AGREEMENTS WITH THE COMPANY’S NAMED EXECUTIVE OFFICERS

We have employment agreements with each of our Chief Executive Officer, Chief Technology Officer and Chief Financial Officer. With the exception of the employment agreement with our Chief Financial Officer, each of these employment agreements provides for an indefinite term. Such employment agreements may be terminated (1) if the employee gives written notice of his or her intention to resign, (2) the employee is absent from three consecutive meetings of the board of directors, without special leave of absence from the other members of the board of directors, and the board of directors passes a resolution that such employee has vacated his office, or (3) the death, bankruptcy or mental incapacity of the employee. The employment agreement for our Chief Financial Officer provides for a one-year term, currently expiring on March 12, 2017. Such employment agreement may be terminated if Ms. Liu gives thirty days' written notice of her intention to resign, or if the board of directors determines she can no longer perform her duties as Chief Financial Officer and provides her with thirty days' written notice of termination.

Under Chinese law, we may only terminate employment agreements without cause and without penalty by providing notice of non-renewal one month prior to the date on which the employment agreement is scheduled to expire. If we fail to provide this notice or if we wish to terminate an employment agreement in the absence of cause, then we are obligated to pay the employee one month's salary for each year we have employed the employee. We are, however, permitted to terminate an employee for cause without penalty to our company, where the employee has committed a crime or the employee's actions or inactions have resulted in a material adverse effect to us.

SUMMARY EXECUTIVE COMPENSATION TABLE

The following table shows the annual compensation paid by us to Mr. Yin Shenping, our Chief Executive Officer, Mr. Chen Guangqiang, our Chief Technology Officer, and Ms. Liu, our Chief Financial Officer, for the years ended June 30, 2015 and 2014. No other employee's total salary exceeded $100,000.

Name and principal position	Year	Salary	Bonus	Option Awards	Restricted Stock Awards		Total
Yin Shenping, Principal Executive Officer	2015	$126,347	$10,000	$ —	$129,239	(1,2)	$265,586
	2014	$125,463	$10,455	$	$47,432	(1)	$183,350
Chen Guangqiang, Chief Technology Officer	2015	$117,343	$10,000	$ —	$169,105	(1,2)	$296,448
	2014	$113,593	$10,000	$ —	$67,365	(1)	$190,958
Liu Jia Chief Financial Officer	2015	$80,000	$7,390	$ —	$7,332	(3)	$94,722
	2014	$80,000	$6,500	$	$—		$86,500

(1) On December 13, 2013, the Company granted 95,181 restricted shares to Mr. Yin Shenping and 135,181 restricted shares to Mr. Chen Guangqiang at an aggregate value of ¥4,207,496 ($688,782), based on the stock closing price of $2.99 at December 13, 2013. These restricted shares will be vested over three years with one third of the shares vesting every year from the grant date.

(2) On January 31, 2015, the Company granted 150,000 restricted shares to Mr. Yin Shenping and 150,000 restricted shares to Mr. Chen Guangqiang at an aggregate value of ¥3,038,558($495,000), based on the stock closing price of $1.65 at January 31, 2015. These restricted shares will vest over three years with one third of the shares vesting every year from the grant date.

(3) On January 31, 2015, the Company granted 32,000 options to Ms. Liu Jia, which options vest over a period of three years, one third of which vest on January 31 of each year beginning in 2016. The grant date fair value of such options was $1.65.

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END

	Option Awards				Shares Awards			
Name	**Number of securities underlying unexercised options (#) exercisable**	**Number of securities underlying unexercised options (#) unexercisable**	**Weighted Option exercise price ($)**	**Option expiration date**	**Number of shares or units of stock that have not vested**	**Market value of shares of units of stock that have not vested ($)**	**Equity incentive plan awards: number of unearned shares, units or other rights that have not vested (#)**	**Equity incentive plan awards: Market or payout of value of unearned shares, units or other rights that have not vested**
(a)	(b)	(c)	(e)	(f)	(g)	(h)	(i)	(j)
Yin Shenping	60,000	-	6.00	July 29, 2019 [2]	31,727	94,864	31,727	94,864 [4]
Principal Executive Officer	32,000	16,000	2.96	March 25, 2022 [3]	50,000	82,500	100,000	165,000 [5]
					-	-	320,000	281,600 [6]
Total	**92,000**	**88,000**	**4.65**		**81,727**	**177,364**	**451,727**	**541,464**
Chen Guangqiang	50,000	-	6.00	July 29, 2019 [2]	45,060	134,729	45,061	134,732 [4]
Chief Technology Officer	20,000	10,000	2.96	March 25, 2022 [3]	50,000	82,500	100,000	165,000 [5]
					-	-	320,000	281,600 [6]
Total	**40,000**	**10,000**	**4.86**		**95,060**	**217,229**	**465,061**	**581,332**

(2) Options granted on July 30, 2009, which vest at a rate of 20% per year on the anniversary of the grant date and which are exercisable for $6.00 per share.

(3) Options granted on March 26, 2012, which vest at a rate of 20% per year on the anniversary of the grant date and which are exercisable for $2.96 per share.

(4) Based on the share price of Oct. 13, 2013.

(5) Based on the share price of Jan 31, 2015.

(6) Based on the share price of Oct. 16, 2015.

EQUITY COMPENSATION PLAN INFORMATION

Plan category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	815,600	$ 3.04	-
Equity compensation plans not approved by security holders	-	$ -	-
Total	815,600	$ 3.04	-

Certain Relationships and Related Transactions, and Director Independence.

Transactions with Related Persons

Because we do not have access certification to Jidong Oilfield, Nanjing Recon, one of our Domestic Companies, conducted transactions with Jidong Oilfield through Beijing Yabei Nuoda Science and Technology Co. Ltd. ("Yabei Nuoda"), which has access certification to the oilfield and wherein one of the Founders, Mr. Yin Shenping, was the legal representative of before December 2013 and Chairman as of September 30, 2014. On October 30, 2014, Mr. Yin resigned from the chairman position and at that point Yabei Nuoda was no longer a related party of the Company after October 30, 2014. Mr. Yin does not have any equity interest in this company currently. Below is a summary of trade accounts receivable with related parties as of June 30, 2014 and 2015, respectively.

Related Party	**June 30, 2014 RMB**	**June 30, 2015 RMB**	**June 30, 2015 U.S. Dollars**
Beijing Yabei Nuoda Science and Technology Co. Ltd. *	¥ 5,441,498	¥ -	$ -
Beijing Langchen Construction Company	726,800	726,800	119,367

Xiamen Huangsheng Hitek Computer Network Co.Ltd.	100,000	980,000	160,951
Xiamen Henda Hitek Computer Network Co. Ltd.	1,211,000	3,063,000	503,055
Total - related-parties, net	¥ 7,479,298	¥ 4,769,800	$ 783,373

Related Party **Non-current portion**	**June 30, 2014** **RMB**	**June 30, 2015** **RMB**	**June 30, 2014** **U.S. Dollars**
Beijing Yabei Nuoda Science and Technology Co. Ltd.	¥ 16,062,574	¥ 4,934,072	$ 810,352
Allowance for doubtful accounts	(1,606,257)	(493,407)	(81,035)
Total - related-parties, net	¥ 14,456,317	¥ 4,440,665	$ 729,317

Below is a summary of purchase advances to related parties as of June 30, 2014 and 2015, respectively

Related Party	**June 30, 2014** **RMB**	**June 30, 2015** **RMB**	**June 30, 2015** **U.S. Dollars**
Xiamen Huangsheng Hitek Computer Network Co. Ltd.	¥ 394,034	¥ 394,034	$ 64,715
Total	¥ 394,034	¥ 394,034	$ 64,715

In addition, included in the Company's other receivables as of June 30, 2015 were amounts "due from ENI" after ENI ceased to be a VIE of the Company on December 16, 2010. In January 2012, ENI agreed to repay the loan on a determined payment schedule, and interest is accrued during the period at an annual rate of 4%. In accordance with the payment schedule, the principal plus accrued interest was to be repaid over three years on a quarterly basis beginning March 2012. The first four payments are RMB 1.2 million each. In March, June, September and December of 2012, the Company received RMB 4.8 million. Starting March 2013, installments for each quarter would be ¥1,777,653. The Company received the payments on time in March and June, 2013. On September 30, 2013, ENI proposed to extend the payment period and signed a new contract with the Company. According to the new arrangement, the remaining balance of this loan will be repaid over four years with quarterly installments of ¥699,147. The Company has continued to receive the payments under the agreement.

Accordingly, the current and non-current portion of the amount due from ENI at June 30, 2015 is RMB 2,624,071 ($430,967) and RMB 2,729,033 ($448,205), respectively.

The Company also had short-term borrowings from related parties. Below is a summary of the Company's short-term borrowings due to related parties as of June 30, 2014 and 2015, respectively.

Short-term borrowings due to related parties:	June 30, 2014 RMB	June 30, 2015 RMB	June 30, 2015 U.S. Dollars
Short-term borrowing from a Founder, 6.6% annual interest, due on December 25, 2014	¥ 5,007,728	¥ -	-
Short-term borrowing from a Founder, 7.2% annual interest, due on October 20, 2015		6,013,200	987,584
Short-term borrowing from a Founder, 6.0% annual interest, due on October 2, 2015		3,403,431	558,966
Short-term borrowing from a Founder, 6.16% annual interest, due on October 12, 2015		1,600,274	262,822
Short-term borrowing from a Founder's family member, no interest, due on various dates.		5,700,000	936,145
Short-term borrowings from Xiamen Huasheng Haitian Computer Network Co. Ltd., no interest, due on November 14, 2015	200,000	200,000	32,847
Total short-term borrowings due to related parties	¥ 5,207,728	¥ 16,916,905	$ 2,778,364

Other than as described herein, no transactions required to be disclosed under Item 404 of Regulation S-K have occurred since the beginning of the Company’s last fiscal year.

Director Independence

The Board of Directors maintains a majority of independent directors who are deemed to be independent under the definition of independence provided by NASDAQ Stock Market Rule 4200(a)(15). Mr. Wong, Mr. Hu and Mr. Zhao are our independent directors.

PROPOSAL 2:

TO RATIFY THE APPOINTMENT OF FRIEDMAN LLP AS THE COMPANY'S INDEPENDENT REGISTERED PUBLIC
ACCOUNTING FIRM FOR THE FISCAL YEAR ENDING JUNE 30, 2016

(ITEM 2 ON THE PROXY CARD)

AUDIT COMMITTEE REPORT AND FEES PAID TO
INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Who served on the Audit Committee of the board of directors during fiscal year 2015?

The members of the Audit Committee as of June 30, 2015 were Nelson N.S. Wong, Zhao Shudong and Hu Jijun. Each member of the Audit Committee is independent under the rules of the SEC and the NASDAQ Capital Market. The board of directors has determined that Mr. Wong, who is an independent director, is an "audit committee financial expert" as such term is defined in Item 407(d)(5) of Regulation S-K promulgated under the Exchange Act.

What document governs the activities of the Audit Committee?

The Audit Committee acts under a written charter, which sets forth its responsibilities and duties, as well as requirements for the Audit Committee's composition and meetings. The Audit Committee Charter is available on the Company's website at www.recon.cn under Investor Relations.

How does the Audit Committee conduct its meetings?

During fiscal 2015, the Audit Committee met with the senior members of the Company's financial management team and the Company's independent registered public accounting firm. The Audit Committee's agenda was established by the Chairman. At each meeting, the Audit Committee reviewed and discussed various financial and regulatory issues. The Audit Committee also had private, separate sessions from time to time with representatives of the Company's independent registered public accounting firm, at which meetings candid discussions of financial management, accounting and internal control issues took place.

Does the Audit Committee review the periodic reports and other public financial disclosures of the Company?

The Audit Committee reviews each of the Company's quarterly and annual reports, including Management's Discussion of Results of Operations and Financial Condition. As part of this review, the Audit Committee discusses the reports with the Company's management and considers the audit and review reports prepared by the independent registered public accounting firm about the Company's quarterly and annual reports, as well as related matters such as the quality (and not just the acceptability) of the Company's accounting principles, alternative methods of accounting under generally accepted accounting principles and the preferences of the independent registered public accounting firm in this regard, the Company's critical accounting policies and the clarity and completeness of the Company's financial and other disclosures.

What is the role of the Audit Committee in connection with the financial statements and controls of the Company?

Management of the Company has primary responsibility for the financial statements and internal control over financial reporting. The independent registered public accounting firm has responsibility for the audit of the Company's financial statements and internal control over financial reporting. The responsibility of the Audit Committee is to oversee financial and control matters, among other responsibilities fulfilled by the Audit Committee under its charter. The Audit Committee meets regularly with the independent registered public accounting firm, without the presence of management, to ensure candid and constructive discussions about the Company's compliance with accounting standards and best practices among public companies comparable in size and scope to the Company. The Audit Committee also regularly reviews with its outside advisors material developments in the law and accounting literature that may be pertinent to the Company's financial reporting practices.

What has the Audit Committee done with regard to the Company’s audited financial statements for fiscal 2015?

The Audit Committee has:

- reviewed and discussed the audited financial statements with the Company’s management; and
- discussed with Friedman LLP, the Company’s independent registered public accounting firm for the 2015 fiscal year, the matters required to be discussed by Statement on Auditing Standards No. 61, Communication with Audit Committees, as amended.

Has the Audit Committee considered the independence of the Company’s auditors?

Friedman LLP has supplied the Audit Committee with written disclosures and the letter required by Independence Standards Board Standard No. 1, Independence Discussions with Audit Committees, and the Audit Committee has discussed Friedman LLP’s independence with Friedman LLP. The Audit Committee has concluded that Friedman LLP is independent from the Company and its management.

Has the Audit Committee made a recommendation regarding the audited financial statements for fiscal 2015?

Based upon its review and the discussions with management and the Company’s independent registered public accounting firm, the Audit Committee recommended to the board of directors that the audited consolidated financial statements for the Company be included in the Company’s Annual Report on Form 10-K for fiscal 2015.

Has the Audit Committee reviewed the fees paid to the independent registered public accounting firm during fiscal 2015?

The Audit Committee has reviewed and discussed the fees paid to Friedman LLP during fiscal 2015 for audit, audit-related, tax and other services, which are set forth below under “Fees Paid to Independent Registered Public Accounting Firm.” The Audit Committee has determined that the provision of non-audit services is compatible with Friedman LLP’s independence.

What is the Company's policy regarding the retention of the Company's auditors?

The Audit Committee has adopted a policy regarding the retention of the independent registered public accounting firm that requires pre-approval of all services by the Audit Committee.

Who prepared this report?

This report has been furnished by the members of the Audit Committee as of June 30, 2015:

Nelson N.S. Wong, Chairman

Zhao Shudong

Hu Jijun

FEES PAID TO INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Audit Fees

During fiscal 2014 and 2015, Friedman LLP's fees for the annual audit of our financial statements and the quarterly reviews of the financial statements included in Forms 10-Q were $185,000 and $190,000, respectively.

Audit-Related Fees

During fiscal 2014 and 2015, Friedman LLP billed the Company $0 for audit-related services.

Tax Fees

The Company was not billed by Friedman LLP for tax services in fiscal 2014 and 2015.

All Other Fees

The Company was not billed by Friedman LLP for any other services in fiscal 2014 and 2015.

Audit Committee Pre-Approval Policies

Before Friedman LLP was engaged by the Company to render audit or non-audit services, the engagement was approved by the Company’s audit committee. All services rendered by Friedman LLP have been so approved.

WE RECOMMEND THAT YOU VOTE FOR THE RATIFICATION OF FRIEDMAN LLP AS THE COMPANY'S FISCAL 2016 INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM.

GENERAL

Compensation Committee Interlocks and Insider Participation

None of the members of the board of directors who served on the Compensation Committee during the fiscal year ended June 30, 2015 were officers or employees of the Company or any of its subsidiaries or had any relationship with the Company requiring disclosure under SEC regulations.

Compliance with Section 16(a) Beneficial Ownership Reporting Requirements

Section 16(a) of the Securities Exchange Act of 1934 requires the Company's directors and executive officers and persons who own more than ten percent of a registered class of the Company's equity securities to file with the Securities and Exchange Commission reports of ownership and changes in beneficial ownership of the Company's ordinary shares. Directors, executive officers and greater than ten percent shareholders are required to furnish the Company with copies of all Section 16(a) forms they file. Based solely on a review of the copies of these reports furnished to the Company or written representations that no other reports were required, we believe that all reports were timely made.

Availability of Form 10-K to Stockholders

Rules promulgated by the SEC require us to provide an Annual Report to Stockholders who receive this Proxy Statement. We will also provide copies of the Annual Report to brokers, dealers, banks, voting trustees and their nominees for the benefit of their beneficial owners of record. Additional copies of the Annual Report on Form 10-K for the fiscal year ended June 30, 2015 (without exhibits or documents incorporated by reference), are available without charge to shareholders upon written request to Secretary, Recon Technology, Ltd, Room 1902, Building C, King Long International Mansion, 9 Fulin Road, Beijing 100107 China, by calling 010-84945799 or via the Internet at www.recon.cn.

Stockholder Proposals

To be considered for inclusion in next year's Proxy Statement or considered at next year's annual meeting but not included in the Proxy Statement, stockholder proposals must be submitted in writing by [*]. All written proposals should be submitted to: Secretary, Recon Technology, Ltd, Room 1902, Building C, King Long International Mansion, 9 Fulin Road, Beijing 100107 China.

Stockholders Sharing an Address

We may send a single set of stockholder documents to any household at which two or more stockholders reside. This process is called "householding." This reduces the volume of duplicate information received at your household and helps us to reduce costs. Your materials may be householded based on your prior express or implied consent. If your materials have been householded and you wish to receive separate copies of these documents, or if you are receiving duplicate copies of these documents and wish to have the information householded, you may write or call the following address or phone number: Secretary, Recon Technology, Ltd.,1902 Building C, King Long International Mansion, 9 Fulin Road, Beijing 100107, People's Republic of China; +86 (10) 8494 5799.

Other Matters to Come Before the Meeting

The board of directors is not aware of any other business to be acted upon at the Annual Meeting. Pursuant to the Company's bylaws, only the business described in the notice of the Annual Meeting of the stockholders will be conducted at such meeting.

Documents Incorporated By Reference

The SEC allows us to "incorporate by reference" information into this Proxy Statement. This means that the Company can disclose important information to you by referring you to another document filed separately with the SEC. The information incorporated by reference is considered to be a part of this Proxy Statement, except for any information that is superseded by information that is included directly in this Proxy Statement or in any other subsequently filed document that also is incorporated by reference herein.

This Proxy Statement incorporates by reference our Annual Report on Form 10-K the fiscal year ended June 30, 2015 filed with the SEC on September 25, 2015 and certain portions of our Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2015 filed with the SEC on November 13, 2015.

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SUMMARY OF INFORMATION RELATED TO PROPOSAL 3 AND PROPOSAL 4

This summary highlights selected information contained in this proxy statement and may not contain all of the information that is important to you. The Company urges you to carefully read this proxy statement in its entirety, as well as the annexes thereto.

The Companies

Recon Technology, Ltd.

Room 1902, Building C, King Long International Mansion

No. 9 Fulin Road

Beijing, 100107

People's Republic of China

(86) 10-84945799

Recon Technology, Ltd. ("Recon") is China's first independent oil and gas field service company to be listed on NASDAQ. Working closely with leading global partners, Recon has achieved rapid growth supplying China's largest oil and gas exploration companies, including Sinopec and China National Petroleum Corporation, with advanced automated technologies, efficient gathering and transportation equipment and reservoir stimulation measures. The solutions Recon provides are aimed at increasing gas and petroleum extraction levels, reducing impurities, improving safety and lowering production costs. For additional information about our company, please visit www.recon.cn.

Qinghai Hua You Downhole Technology Co., Ltd.

No. 0467, Huang Chen Road

Hua Tu Gou, Mang Ya City

Qinghai Province, P.R. China 817500

+86 937-8911810

Established in September 2011, Qinghai Hua You Downhole Technology Co., Ltd. ("QHHY") is an oilfield service company providing a wide range of downhole technology support and services primarily in Qinghai province. QHHY has more than 130 employees and is a qualified oilfield service provider for PetroChina, among other companies. QHHY's solutions are aimed at keeping working wells safe and helping to increase oil well production.

Recon Hengda Technology (Beijing) Co., Ltd.

Room 5771, 5th Floor

Shen Chang Building, Zhi Chun Road

Haidian District, Beijing

People’s Republic of China 100107

+86 10-84945799

Recon Hengda Technology (Beijing) Co., Ltd. is a wholly owned subsidiary of the Company and was established as a limited liability company under the laws of the PRC on January 18, 2014.

The Share Purchase Agreement

On December 1, 2015 the Company entered into the Share Purchase Agreement with QHHY, QHHY’s Shareholders and Recon BJ, pursuant to which the Company will issue 2,686,567 ordinary shares and make a cash payment of up to $4.8 million to the QHHY Shareholders in exchange for the control and eventual acquisition of QHHY by Recon BJ through a series of Control Agreements.

Covenants of the Parties

The Share Purchase Agreement contains, among other things, the following covenants and agreement of the parties:

- Recon BJ shall be entitled to all the rights of the QHHY Shareholders, as shareholders of QHHY, upon execution of the Control Agreements;
- the QHHY Shareholders agree not to compete in any way with QHHY’s business;
- the QHHY Shareholders will guarantee the performance of QHHY under the Share Purchase Agreement and will be jointly and severally liable for QHHY’s actions;

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- the QHHY Shareholders will ensure that all of QHHY's key management and technical staff sign employment and related non-disclosure and non-compete agreements for a period of no less than five years;
- QHHY and the QHHY Shareholders will coordinate with the registration of the pledge of 100% of QHHY's Shares within 30 days of the execution of the Share Purchase Agreement; and
- the QHHY Shareholders will complete, or assist QHHY and Recon BJ in completing, the foreign exchange registration.

Amendment and Termination

The Share Purchase Agreement may only be amended pursuant to a written consent signed by each of the parties to the Share Purchase Agreement.

The Share Purchase Agreement may be terminated prior to the closing date as follows:

- by mutual written consent of the parties;
- by written notice by either party if the other party has breached any of their respective representations, warranties, covenants or agreements, and such breach is not cured within 30 days;
- by written notice by either party if the other party has breached any of their respective representations, warranties, covenants or agreements twice or more; or
- by either party if the Share Purchase Agreement cannot be performed due to force majeure.

See "The Share Purchase Agreement," beginning on page 27, for a more complete discussion of the terms of the Share Purchase Agreement.

The Control Agreements

In connection with the Share Purchase Agreement, Recon BJ entered into a series of control agreements with QHHY and its shareholders related to the transfer of ownership and control in QHHY to Recon BJ. Set forth below is a description of each of the Control Agreements:

Exclusive Technical Consulting and Service Agreement

On December 1, 2015, Recon BJ and QHHY entered into an Exclusive Technical Consulting and Service Agreement (the “Consulting Agreement”). Pursuant to the Consulting Agreement, Recon BJ will provide technical consulting and services and other significant resources necessary for the operation of QHHY’s business for a consulting fee equal to 100% of QHHY’s quarterly profit, among other things.

The Consulting Agreement becomes effective upon execution and has a term of 30 years, subject to automatic extension for another 30 year period unless it is terminated by the parties in accordance with the terms of the agreement. Recon BJ has the right to terminate the Consulting Agreement unilaterally with a 30 days’ written notice. QHHY may not terminate the Consulting Agreement except in the case of Recon BJ’s gross negligence, fraud, or other illegal action or bankruptcy.

Exclusive Equity Interest Purchase Agreement

Under the Exclusive Equity Interest Purchase Agreement (the “Equity Interest Purchase Agreement”), Recon BJ is granted the exclusive right to purchase a portion or all of the equity interest of QHHY for a transfer fee to be confirmed by the parties through negotiation according to the appraisal of the equity interest approved by the competent authority, which shall be the lowest price permitted under the laws and regulations of the People’s Republic of China (“PRC”). The transfer fee will be refunded to Recon BJ when Recon BJ exercises its purchase right. The Equity Interest Purchase Agreement is effective upon execution and has a term of 10 years, subject to an additional 10 year extension at the discretion of Recon BJ.

Equity Interest Pledge Agreement

Under the Equity Interest Pledge Agreement (the “Pledge Agreement”), the QHHY Shareholders pledged all of their equity interest in QHHY to Recon BJ to guarantee the payment of the technical consulting service fee under the Consulting Agreement. Under the terms of the Pledge Agreement, upon the occurrence of any event of default, as set forth in the Pledge Agreement, including QHHY’s failure to pay the service fee under the Consulting Agreement, Recon BJ, as pledgee, will be entitled to foreclose the pledged equity interest. During the term of the Pledge Agreement, Recon BJ is entitled to possess the contribution certificate of the pledged equity interest as well as QHHY’s register of shareholders in order to collect dividends generated by the pledged equity interest. The QHHY Shareholders also agree that, Recon BJ may notify the QHHY Shareholders of the default and demand full payment of all outstanding service fee and other payable under the Consulting Agreement or may foreclose the pledged equity interest. QHHY Shareholders further agree not to dispose of the pledged equity interest or take any actions that would prejudice Recon BJ’s interest. The Pledge Agreement becomes effective on the date when the pledge is recorded and will continue till the service fee under the Consulting Agreement are paid in full and QHHY no longer undertakes any obligation under the Consulting Agreement.

Power of Attorney

Each of the QHHY Shareholders executed a power of attorney ("Power of Attorney") authorizing Recon BJ to act as his sole representative with full authority to perform shareholder's rights on their behalf, including but not limited to: (i) the attendance of shareholders' meetings and execution of relative shareholder resolution(s); (ii) the exercise of all the shareholder's rights, including voting, that shareholders are entitled to under the PRC law and the Articles of Association, including but not limited to the sale, transfer, pledge or disposition of shares in part or in whole, and (iii) the designation and appointment on behalf of each shareholder the legal representative, the executive director, supervisor, the chief executive officer and other senior management members of QHHY. The Power of Attorney is irrevocable and continuously valid as long as the QHHY Shareholders remain shareholders of QHHY.

At that time, Interests of Directors and Executive Officers in the Transactions

The Company's directors and executive officers do not presently have any interest in the proposal that is not shared by the shareholders of the Company. Mr. Chen was one of the original investors and a founder of QHHY, having held an 80% equity interest in QHHY. From QHHY's founding in 2011 until March of 2013, Mr. Chen, who was then based in Beijing, was involved in the management and oversight of QHHY's operations, specifically by setting up QHHY's management team to run QHHY's business in Qinghai Province. Mr. Chen brought in additional investors, reducing his equity interest in QHHY to 40% on March 18, 2013. At that time, Mr. Chen turned over management of QHHY to the other shareholders, each of whom were oil field professionals, and thereafter his involvement with QHHY was solely that of a shareholder, assisting in making major decisions through participation in shareholder meetings, but otherwise not involved in the day-to-day management and oversight of QHHY's operations. On December 15, 2014, Mr. Chen, along with some of the other QHHY shareholders, sold his 40% equity interest in QHHY. After the sale of all of his ownership in QHHY, as of December 16, 2015, Mr. Chen no longer had any direct or indirect involvement in QHHY. Mr. Chen introduced QHHY to the Company as a candidate for acquisition after the Company had considered several other acquisition candidates and had failed to reach satisfactory acquisition terms. Mr. Chen and Mr. Yin, our Chairman and Chief Executive Officer, negotiated the terms of the Transactions on behalf of the Company's board of directors.

Ownership of Ordinary Shares of the Company after the Transactions

The issuance of the ordinary shares pursuant to the Share Purchase Agreement will have a significant dilutive effect on our existing shareholders. We presently have 5,804,005 ordinary shares outstanding. Following the closing of the Share Purchase Agreement, we will have 8,490,572 ordinary shares outstanding. At that time, the existing shareholders of the Company will hold approximately 68.36% of the issued and outstanding ordinary shares of the Company and the QHHY Shareholders together will hold approximately 31.64% of the outstanding ordinary shares of the Company.

Anticipated Accounting Treatment

The transaction will be treated by the Company as a business combination under the purchase method of accounting in accordance with accounting principles generally accepted in the United States. For accounting purposes, the Company is considered to be acquiring QHHY in this transaction. Therefore, the aggregate consideration paid in connection with the Transactions, together with the direct costs of the Transactions, will be allocated to QHHY's tangible and intangible assets and liabilities based on their fair market values. The assets and liabilities and results of operations of QHHY will be consolidated into the results of operations of the Company as of the effective time of the Transactions. The Company has provided a preliminary pro forma financial information in this proxy statement for shareholders' reference.

Regulatory Approvals Required for the Transactions

Other than the approval of the NASDAQ Stock Exchange, we are not aware of any regulatory filings or approvals that are required in connection with the Transactions.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This proxy statement includes “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995 that are subject to risks, uncertainties and other factors, including the risk that the merger will not be consummated, as the merger is subject to certain closing conditions. All statements other than statements of historical fact are statements that could be deemed forward-looking statements, including statements regarding the expected timing of the completion of the closing of the Share Purchase Agreement; the ability to obtain approval for listing on the Nasdaq of the ordinary shares of the Company issuable pursuant to the Share Purchase Agreement; the ability to obtain approvals from the stockholders and to complete the Transactions considering the various closing conditions; any statements of the plans, strategies and objectives of management for future operations; any statements regarding product development, product extensions, product integration or product marketing; continued compliance with government regulations, changing legislation or regulatory environments; any statements of expectation or belief and any statements of assumptions underlying any of the foregoing. In addition, if and when the Transactions are consummated, there will be risks and uncertainties related to successfully managing the operations of QHHY, as well as the ability to ensure continued regulatory compliance, performance and/or market growth. These risks, uncertainties and other factors, and the general risks associated with the businesses of the Company and QHHY described herein and in the reports and other documents filed with the SEC, could cause actual results to differ materially from those referred to in the forward-looking statements. You are cautioned not to rely on these forward-looking statements. All forward-looking statements are based on information currently available to the Company and QHHY and are qualified in their entirety by this cautionary statement. The information contained in this proxy statement speaks as of the date hereof and we have or undertake no obligation to update or revise these forward-looking statements, whether as a result of new information, future events or otherwise.

PROPOSAL 3:

TO APPROVE AND ADOPT THE SHARE PURCHASE AGREEMENT AND THE TRANSACTIONS

CONTEMPLATED THEREBY

The following is a discussion of the material terms of the Share Purchase Agreement and the Transactions contemplated thereunder. You are urged to carefully read the Share Purchase Agreement in its entirety, a copy of which, along with the Control Agreements, is attached as Annex A to this Proxy Statement and incorporated by reference herein.

Background

For the past few years, the Company has been searching for a suitable acquisition target to complement its existing oilfield business. After searching for acquisition targets, but being unable to locate a suitable target, on or about November 2014, Mr. Chen recommended that the Company consider QHHY. Thereafter, the Company approached the shareholders of QHHY and initiated discussions concerning the Company's potential acquisition of QHHY. The Company's board of directors was informed of the discussion and provided information about the business of QHHY. The board of directors believed QHHY's business to be stable and capable of generating strong cash flow for the Company. As such, the board of directors authorized Messrs. Chen and Yin to continue negotiations with the QHHY Shareholders. Mr. Chen, who had been a major shareholder of QHHY and has had a history of involvement with QHHY's operations, felt he was qualified to provide the Company guidance on the potential acquisition. In addition, Mr. Li Donglin, who is in charge of the operations of the Qinghai department of one of the Company's subsidiaries, had been a shareholder of QHHY and continues to be involved in QHHY's operations. Such relationships and arrangements were fully disclosed to the board of directors. Messrs. Chen and Li later transferred their equity interests in QHHY in December 2014.

After several rounds of negotiations, the parties agreed on the principal terms of the proposed transaction, including how QHHY's management would proceed following the consummation of the Transactions. The Company and QHHY agreed as follows: (i) the Company will take over daily operations and management of QHHY, (ii) the QHHY Shareholders will not require a position on the Company's board of directors, (iii) the QHHY Shareholders will coordinate with Messrs. Yin and Chen on the transition and operation of QHHY's business; (iv) the shares of the Company to be issued to the shareholders of QHHY will be subject to a 12-month lock-up period; and (v) the QHHY Shareholders will hire consultants to help with the financial reporting and preparation of audited financial statements and valuation. To ensure a fair purchase price for the Transactions, the Company engaged an independent third party valuation firm, Avista Group ("AVA"), to prepare a professional valuation report (the "Valuation Report") with respect to the contemplated transactions with shareholders of QHHY. AVA is a comprehensive financial services provider, with offices in Hong Kong, Beijing and Shanghai. AVA's services include business valuation, corporate finance, M&A advisory and property consulting services, along with other value added services.

Prior to engaging AVA, the Company contacted several valuation firms and finally selected three professional firms from which to consider, as is required by the Company's internal control policies. After comparing the background of the valuation firms, including each valuation team's experience and each firm's detailed proposal, the Company hired AVA to serve as the Company's valuation expert in this Transaction. No one at the Company, its board of directors, or, to the Company's knowledge, anyone at QHHY had any relationships with AVA prior to this Transaction.

The Company paid AVA RMB 75,000 (US$11,583) for the preliminary Valuation Report and has agreed to pay AVA a total of RMB 50,000 ($7,721) to 100,000 ($15,443) in additional consideration for the preparation of subsequent valuation reports to (i) value QHHY's goodwill following stockholder approval of the Merger and (ii) value QHHY two years after the transaction is complete in order to determine QHHY's profit for fiscal years 2016 and 2017.

AVA prepared the Valuation Report based on historical and projected business information and financial data provided by QHHY. AVA also conducted independent interviews with QHHY's management team to assess the reasonability of the information they received. The Company was available to provide AVA any additional information as needed, but the Company did not impose any limitations or guidelines on AVA for how it conducted its investigation. As such, AVA independently built a valuation model for QHHY using key data independently selected by AVA based on AVA's prior experience, its knowledge of the proposed transaction and US GAAP requirements. AVA expressed to the Company that their conclusion should be independent and not affected by outside factors or considerations.

The Valuation Report AVA presented to the Company reviewed, among other things, QHHY's current equity value, business enterprise value and P/E ratios, and provided comparisons of those values to comparable companies. In addition, the Valuation Report included projections of QHHY's growth rate for fiscal years 2015 through 2020 of between 11%-29%, tapering off to a 3% growth rate in 2021 and projected growth in QHHY's profit margin at between 40-45% from 2015 to 2021. In addition, the Valuation Report projected QHHY's net profit margin growing consistently between 27% to 30% during the same period, with projected net profit of RMB 4.7 million growing to RMB 11.8 million by 2020/2021.

It should be noted that the Valuation Report was not a fairness opinion. The Valuation Report was prepared for the sole purpose of providing guidance to the Company's management and its board of directors in determining the fair value of QHHY.

The Valuation Report will be made available for inspection and copying at the principal executive offices of the Company during regular business hours by any interested equity holder of the Company or a representative who has been so designated in writing.

On November 24, 2015, the board of directors held a meeting to discuss the Share Purchase Agreement and the Transactions. The financial statements and business of QHHY, as well as the Valuation Report, were presented to the board of directors to assist in their evaluation and consideration of the Share Purchase Agreement and the Transactions. In reaching its decision, the board of directors consulted with the Company’s senior management, financial advisors and outside legal counsel. These consultations included discussions regarding strategic and operational matters, past and current business operations, and financial condition and performance of QHHY. The board of directors approved and adopted, by a unanimous vote, the Share Purchase Agreement and the Transactions and declared the Share Purchase Agreement and the Transactions to be advisable, fair to, and in the best interests of, the Company and its stockholders and recommended that the stockholders vote in favor of the Share Purchase Agreement and the Transactions.

The decision of the board of directors to approve and authorize the Share Purchase Agreement and the Transactions was the result of careful consideration of numerous factors by the board of directors, including, among others, the factors detailed below:

- QHHY’s financial condition and short-term and long-term outlook, including the Valuation Report;
- the effect of the QHHY acquisition, including the consideration to be paid in relation thereto, on the Company’s financial condition;
- the suitability of QHHY’s business to that of Recon, including its products and services, employees and management;
- QHHY’s business partners, contracts, and opportunities for expansion and cooperation with other parties as a result of the acquisition; and
- QHHY’s certification and the possibility of business integration with Recon’s current client base.

Following the board of directors approval of the Transactions on November 24, 2015, on December 1, 2015, the Company executed the Share Purchase Agreement. The terms of the Share Purchase Agreement are more fully described in the section entitled “The Share Purchase Agreement” starting on page 27.

The Company intends to close the Share Purchase Agreement and the Transactions promptly following stockholder approval of this Proposal 1.

Interests of Directors and Executive Officers in the Transactions

The Company's directors and executive officers do not presently have any interest in the proposal that is not shared by the stockholders of the Company. QHHY had been majority owned by Mr. Chen Guangqiang, who is the Company's Chief Technology Officer and a director of the Company, until he disposed of half his ownership interest in 2013 and then sold his remaining interests in December 2014. Mr. Chen sold his ownership interest in QHHY on December 15, 2014 and no longer has any involvement in QHHY's business at this time. We expect Mr. Chen's experience with and knowledge of QHHY will assist us in integrating QHHY's business into the Company's business going forward. In addition, when Mr. Chen owned shares in QHHY, he was responsible for establishing the management of QHHY, thus providing him with great knowledge and insight into QHHY's operations, management and personnel.

Ownership of Ordinary Shares of the Company after the Transactions

The issuance of the ordinary shares pursuant to the Share Purchase Agreement will have a significant dilutive effect on our existing shareholders. Subsequent to the closing of the Share Purchase Agreement, we will have 8,490,572 ordinary shares of outstanding. Following the closing of the Share Purchase Agreement, the existing shareholders of the Company will hold approximately 68.36% of the issued and outstanding ordinary shares of the Company and the QHHY Shareholders will hold approximately 31.64% of the outstanding ordinary shares of the Company.

Regulatory Approvals Required for the Transactions

We are not aware of any regulatory filings or approvals that are required in connection with the Transactions.

Restrictions on Sales of Ordinary Shares Received in the Transactions

The ordinary shares to be issued in the Transactions will be restricted and subject to a 12-month lock-up period.

Listing of Ordinary Shares Issued in the Transactions

Before the completion of the Transactions, the Company will use its commercially reasonable efforts to cause the ordinary shares to be issued in the Transactions to be authorized for listing on NASDAQ, subject to official notice of issuance.

Anticipated Accounting Treatment

The Transaction will be treated by the Company as a business combination under the purchase method of accounting in accordance with accounting principles generally accepted in the United States. For accounting purposes, the Company is considered to be acquiring QHHY in this Transaction. Therefore, the aggregate consideration paid in connection with the Transactions will be allocated to QHHY's tangible and intangible assets and liabilities based on their fair market values. There have been no intangible assets of QHHY recognized before this acquisition. The assets and liabilities and results of operations of QHHY will be consolidated into the results of operations of the Company as of the effective time of the Transactions. The Company has provided preliminary pro forma financial information in this proxy statement for shareholders' reference.

Appraisal Rights

The stockholders do not have appraisal or dissenters' rights under the Company's organizational documents or under the Cayman Islands law.

THE SHARE PURCHASE AGREEMENT

The following is a summary of the material provisions of the Share Purchase Agreement, and the Control Agreements which are attached as exhibits to the Share Purchase Agreement, which is attached as Annex A to this proxy statement and is incorporated by reference herein. This summary does not purport to be complete and may not contain all of the information about the Share Purchase Agreement that is important to you. We encourage you to read carefully the Share Purchase Agreement in its entirety, as the rights and obligations of the parties thereto are governed by the express terms of the Share Purchase Agreement and not by this summary or any other information contained in this proxy statement.

Form and Effective Time of the Transactions

Subject to the terms and conditions of the Share Purchase Agreement, at the effective time of the Transactions, the Company will, through the Control Agreements, have the power, rights and obligations equivalent in all material respects to those it would possess as the sole equity holder of QHHY, including absolute control rights and the rights to the assets, property and revenue of QHHY.

The Transactions will become effective upon satisfaction of the closing conditions of the Share Purchase Agreement, including but not limited to the approval by the Company's shareholders of the Share Purchase Agreement and the Transactions contemplated thereunder.

Consideration to be Received in the Transactions

Share Issuance

We will issue, as consideration to the QHHY Stockholders, $3.6 million worth of ordinary shares of the Company. The shares will be issued at 120% of the weighted and average closing price of the Company's ordinary shares for the 20 trading days immediately preceding the date of the Share Purchase Agreement, which is equal to 2,686,567 shares. The ordinary shares will be restricted and subject to a 12-month lock-up period.

The issuance of 2,686,567 ordinary shares in accordance with the terms of Share Purchase Agreement are subject to the satisfaction of the following material conditions:

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- QHHY provides full and complete disclosure of QHHY's assets, liabilities, shareholder equity, guarantees and other relevant information;
- there exists no material adverse change to the business and financial conditions of QHHY between the date of the parties' entrance into the Share Purchase Agreement and the issuance of the Company's ordinary shares thereunder;
- QHHY maintains its good standing and will not conduct its business or act in any manner that would be in violation of applicable law;
- QHHY shall conduct its business in all material respects in the ordinary course of business consistent with past practice and maintain and preserve substantially intact its business organization, assets and properties; keep available the services of its directors, officers and employees; and preserve substantially intact existing relationships with all persons with whom QHHY does significant business;
- QHHY will not dispose of or pledge its major assets or incur any significant debt except that such debt or disposal is incurred in its ordinary course of business and the amount does not exceed $50,000 individually or in the aggregate;
- QHHY will not engage in certain activities without the prior written consent of Recon BJ, as more fully described in the section entitled, "Representations and Warranties," below.

The Company will issue the ordinary shares after the following conditions have been met:

- the Company has completed its due diligence of QHHY to its satisfaction;
- all relevant consents and approvals have been obtained in connection with the share issuance, including approval by the Company's stockholders, QHHY and any required third party, relevant government and the NASDAQ Stock Market;
- the parties have signed the Control Agreements; and
- QHHY has experienced no material adverse change.

The ordinary shares, once issued, will be restricted and subject to a 12-month lock-up period.

Cash Consideration

We will also make a cash payment of up to $4.8 million (the "Cash Payments") to the QHHY Shareholders, which Cash Payments are subject to QHHY achieving certain revenue targets for fiscal year 2016 and 2017. The Cash Payments will be determined as follows:

- if QHHY achieves a net profit increase of 15% for both the fiscal years 2016 and 2017, the Company will make Cash Payments of $1.4 million ("FY 2016 Base Payment") and $1.0 million ("FY 2017 Based Payment"), respectively, to QHHY Shareholders;

- if QHHY achieves a net profit increase of more or less than 15% for the fiscal years 2016 and 2017, the Company will make Cash Payments equal to (i) FY 2016 Base Payment or FY 2017 Base Payment multiplied by (ii) the quotient of the percentage of the net profit increase percentage for the respective fiscal year divided by 15%.;

- if QHHY's profit decreases for FY 2016, the Company will not be required to make any Cash Payments.

Representations and Warranties

The Share Purchase Agreement contains customary representations and warranties made by the parties to each other. Many of the representations and warranties are qualified by material adverse effect or by a materiality standard. Several are qualified by knowledge standards. These representations and warranties relate to, among other things:

- organization, existence and good standing;
- authorization, binding agreement;
- no violations;
- no material omission, misleading or false information;
- absence of undisclosed legal proceedings; and
- financial statements

Without limiting the generality of the foregoing, during the period between the execution date of the Share Purchase Agreement and the issuance of shares thereunder, QHHY will not, without the prior written consent of Recon BJ:

- amend, waive or otherwise change, in any respect, its organizational documents;

- authorize for issuance, issue, grant, sell, pledge, dispose of or propose to issue, grant, sell, pledge or dispose of any of its capital stock or any options, warrants, commitments, subscriptions or rights of any kind to acquire or sell any of its securities or equity interests;
- split, combine, recapitalize or reclassify any of its equity interests or issue any other securities in respect thereof or declare, pay or set aside any distribution or other dividend (whether in cash, equity or property or any combination thereof) in respect of its equity interests, or directly or indirectly redeem, purchase or otherwise acquire or offer to acquire any of its securities or equity interests;
- incur, create, assume or otherwise become liable for any indebtedness in excess of $50,000 (individually or in the aggregate), make a loan or advance to or investment in any third party, or guarantee or endorse any indebtedness, liability or obligation of any third party
- increase the wages, salaries or compensation of any of its employees by more than five percent (5%), or increase bonuses for the foregoing individuals in excess of five percent (5%), or make commitments to advance with respect to bonuses for fiscal year 2016 or 2017, or materially increase other benefits of any of the foregoing individuals, or enter into, establish, materially amend or terminate any benefits plans;
- make or rescind any material election relating to taxes, settle any claim, action, suit, litigation, proceeding, arbitration, investigation, audit or controversy relating to taxes, file any amended tax return or claim for refund, or make any material change in its accounting or tax policies or procedures;
- transfer or license to any person or otherwise extend, materially amend or modify, permit to lapse or fail to preserve any material intellectual property, or disclose to any person who has not entered into a confidentiality agreement any trade secrets;
- terminate or waive or assign any material right under any material contracts, or enter into any material contracts;
- fail to maintain its books, accounts and records in all material respects in the ordinary course of business consistent with past practice;
- establish any subsidiary or enter into any new line of business;
- fail to use commercially reasonable efforts to keep in force insurance policies or replacement or revised policies providing insurance coverage;
- revalue any of its material assets or make any change in accounting methods, principles or practices;
- waive, release, assign, settle or compromise any claim, action or proceeding, other than those that involve only the payment of monetary damages not in excess of $50,000 in the aggregate;
- close or materially reduce any activities, or effect any material layoff or other material personnel reduction or change, at any facility;
- acquire, including by merger, consolidation, acquisition of stock or assets, or any other form of business combination, any corporation, partnership, limited liability company, other business organization or any division thereof, or any material amount of assets;
- make capital expenditures in excess of $50,000 (individually or in the aggregate);
- adopt a plan of complete or partial liquidation, dissolution, merger, consolidation, restructuring, recapitalization or other reorganization;
- voluntarily incur any liability or obligation (whether absolute, accrued, contingent or otherwise) in excess of $50,000 (individually or in the aggregate) other than pursuant to the terms of an existing arrangement;
- sell, lease, license, transfer, exchange or swap, mortgage or otherwise pledge or encumber (including securitizations), or otherwise dispose of a material portion of its properties, assets or rights other than the sale of inventory in the ordinary course of business;
- enter into any agreement, understanding or arrangement with respect to the voting of QHHY’s securities;
- take any action in violation of the agreement that would reasonably be expected to delay or impair the obtaining of any consents or approvals of any governmental authority to be obtained in connection with this agreement; or
- enter into, amend, waive or terminate (other than terminations in accordance with their terms) any affiliate transactions.

Covenants of the Parties

The Share Purchase Agreement contains, among other things, the following covenants and agreement of the parties:

- Recon BJ shall be entitled to all of the rights of the QHHY Shareholders as shareholders upon execution of the Control Agreements;
- the QHHY Shareholders agree not to complete in any way with QHHY's business;
- the QHHY Shareholders will guarantee the performance of QHHY under the Share Purchase Agreement and will be jointly and severally liable for QHHY's actions;

- the QHHY Shareholders will ensure that key management and technical staff sign employment and related non-disclosure and non-compete agreements for a period of no less than five years;
- QHHY and QHHY Shareholders will coordinate with the registration of the pledge within 30 days of the execution of the Share Purchase Agreement; and
- the QHHY Shareholders will complete or assist QHHY and Recon BJ with the foreign exchange registration process.

Amendment and Termination

The Share Purchase Agreement may only be amended pursuant to a written agreement signed by each of the parties to the agreement.

The Share Purchase Agreement may be terminated prior to the closing date as follows:

- by mutual written consent of the parties;
- by written notice by either party if the other party has breached any of their respective representations, warranties, covenants or agreements, and such breach is not cured within 30 days;
- by written notice by either party if the other party has breached any of their respective representations, warranties, covenants or agreements twice or more; or
- by either party if the Share Purchase Agreement cannot be performed due to force majeure.

Governing Law

The Share Purchase Agreement is governed by, and will be construed in accordance with, the laws of the PRC.

The Control Agreements

In connection with the Share Purchase Agreement, Recon BJ entered into a series of control agreements with QHHY and its shareholders related to the transfer of ownership in QHHY to Recon BJ. Set forth below is a description of each of the Control Agreements:

Exclusive Technical Consulting and Service Agreement

On December 1, 2015, Recon BJ and QHHY entered into an Exclusive Technical Consulting and Service Agreement (the “Consulting Agreement”). Pursuant to the Consulting Agreement, Recon BJ will provide technical consulting and services and other significant resources necessary for the operation of QHHY’s business for a consulting fee equal to 100% of QHHY’s quarterly profit, among other things.

The Consulting Agreement becomes effective upon execution and has a term of 30 years, subject to automatic extension of another 30 year period unless it is terminated by the parties in accordance with the terms of the Consulting Agreement. Recon BJ has the right to terminate the Consulting Agreement unilaterally with a 30 day written notice. QHHY may not terminate the Consulting Agreement except in the case of Recon BJ’s gross negligence, fraud, or other illegal action or bankruptcy.

Exclusive Equity Interest Purchase Agreement

On December 1, 2015, Recon BJ, QHHY and the QHHY Shareholders entered into an Exclusive Equity Interest Purchase Agreement (the “Equity Interest Purchase Agreement”). Pursuant to the Equity Interest Purchase Agreement, Recon BJ is granted the exclusive right to purchase a portion or all of the equity interest of QHHY for a transfer fee to be confirmed by the parties through negotiation according to the appraisal of the equity interest approved by the competent authority, which shall be the lowest price permitted under the PRC law and regulations. The transfer fee will be refunded to Recon BJ when Recon BJ exercises its purchase right. The Equity Interest Purchase Agreement is effective upon execution and has a term of 10 years, subject to extension for another 10 years at the discretion of Recon BJ.

Equity Interest Pledge Agreement

On December 1, 2015, Recon BJ, QHHY and the QHHY Shareholders entered into the Equity Interest Pledge Agreement (the “Pledge Agreement”) pursuant to which the QHHY Shareholders pledged all their equity interest in QHHY to Recon BJ to guarantee the payment of the technical consulting service fee under the Consulting Agreement. Under the terms of the Pledge Agreement, upon the occurrence of any event of default, as set forth in the Pledge Agreement including QHHY’s failure to pay the service fee under the Consulting Agreement, Recon BJ, as pledgee, will be entitled to foreclose the pledged equity interest. During the term of the agreement, Recon BJ is entitled to possess the contribution certificate of the pledged equity interest as well as QHHY’s register of shareholders in order to collect dividends generated by the pledged equity interest. The QHHY Shareholders also agree that Recon BJ may notify the QHHY Shareholders of any default and demand full payment of all outstanding service fees and other payables owed under the Consulting Agreement or, alternatively, Recon BJ may foreclose on the pledged equity interest. The QHHY Shareholders further agree not to dispose of the pledged equity interest or take any actions that would prejudice Recon BJ’s interest. The Pledge Agreement becomes effective on the date when the pledge is recorded and will continue until the service fees due under the Consulting Agreement are paid in full and QHHY no longer undertakes any obligation under the Consulting Agreement.

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Power of Attorney

Each of the QHHY Shareholders has executed an individual power of attorney (each a “Power of Attorney”) authorizing Recon BJ as his or her sole representative with full authority to perform the shareholder’s rights on his or her behalf, including but not limited to: (i) attendance of shareholders’ meetings and execution of shareholder resolution(s); (ii) the exercise of all the shareholder’s rights, including voting rights, that shareholders are entitled to under PRC law and the QHHY’s articles of association, including but not limited to the sale, transfer, pledge or disposition of shares in part or in whole, and (iii) the designation and appointment on behalf of the shareholders a legal representative, executive director, supervisor, chief executive officer and other senior management members of QHHY. Each Power of Attorney is irrevocable and continuously valid so long as the QHHY Shareholders remain shareholders of QHHY.

INFORMATION ABOUT THE COMPANY

BUSINESS

General

Recon Technology Ltd. was incorporated under the laws of the Cayman Islands on August 21, 2007 by Messrs. Yin Shenping, Chen Guangqiang and Li Hongqi (the “Founders”) as a limited liability with the purpose of providing hardware, software, and on-site services to companies operating in the petroleum mining and extraction industry. Our services are designed to automate and enhance the extraction of petroleum. We primarily provide products and services to petroleum companies based in mainland China.

Our wholly owned subsidiary, Recon Technology Co., Limited (“Recon-HK”) was incorporated on September 6, 2007 in Hong Kong. Other than the equity interest in Recon-HK, the Company does not own any assets or conduct any operations. On November 15, 2007, Recon-HK established one wholly owned subsidiary, Jining Recon Technology Ltd. (“Recon-JN”) under the laws of the PRC. Other than the equity interest in Recon-JN, Recon-HK does not own any assets or conduct any operations. On November 19, 2010, the Company established one wholly owned subsidiary, Recon Investment Ltd. (“Recon-IN”) under the laws of HK. On January 18, 2014, Recon-IN established one wholly owned subsidiary, Recon Hengda Technology (Beijing) Co., Ltd. (“Recon BJ”) under the laws of the PRC. Other than the equity interest in Recon BJ, Recon-IN does not own any assets or conduct any operations.

Presently, the Company conducts its business through the following PRC legal entities that are consolidated as variable interest entities ("VIEs") and operate in the Chinese oilfield equipment and service industry:

1. Beijing BHD Petroleum Technology Co., Ltd. ("BHD"), and
2. Nanjing Recon Technology Co., Ltd. ("Nanjing Recon").

We refer to BHD, Nanjing Recon collectively as the "Domestic Companies" in this Proxy Statement.

The Company serves as the center of strategic management, financial control and human resources allocation for the Domestic Companies. Through our contractual relationships with the Domestic Companies, we provide equipment, tools and other hardware related to oilfield production and management, and develop and sell our own specialized industrial automation control and information solutions. However, we do not engage in the production of petroleum or petroleum products.

We believe that one of the most important advancements in China's petroleum industry has been the automation of significant segments of the exploration and extraction process. The Domestic Companies' and our automation products and services allow petroleum mining and extraction companies to reduce their labor requirements and improve the productivity of oilfields. The Domestic Companies' and our solutions allow our customers to locate productive oilfields more easily and accurately, improve control over the extraction process, increase oil yield efficiency in tertiary stage oil recovery, and improve the transportation of crude oil.

Over the past several years, our capacity to provide integrated services has been a significant factor for our long-term growth and development. We treat simulation measures around fracturing as our entry point for our integrated service model. To date, we have formed new business modules through our own research and development, investment in service-team building and development of a integrated services solutions for stimulation.

Market Background

China is the world's second-largest consumer of petroleum products, third-largest importer of petroleum and sixth-largest producer of petroleum. Over the last twenty years, China's demand for oil has more than tripled, while its production of oil has only modestly increased. China became a net importer of petroleum in 1983 and, since then, oil production in China has been focused on meeting the country's domestic oil consumption requirements. The oil industry in China is dominated by three state-owned holding companies: China National Petroleum Corporation (CNPC), China Petroleum and Chemical Corporation (Sinopec) and China National Offshore Oil Corporation (CNOOC). Foreign companies have also recently become involved in China's petroleum industry; however, according to Chinese law, China's national oil companies may take a majority (or minority) stake in any commercial discovery. As a result, the number of major foreign companies involved in the industry is relatively limited major foreign oil companies operating in China include: Agip, Apache, BP, ChevronTexaco, ConocoPhillips, Eni, ExxonMobil, Husky Energy, Kerr-McGee, Mitsubishi, Royal Dutch Shell, Saudi Aramco and Total.

In the past, China's petroleum companies mined for petroleum by leveraging the country's abundance of inexpensive labor, rather than focusing on developing new technologies. For example, a typical, traditional oilfield with an annual capacity of 1,000,000 tons would require between 10,000 and 20,000 laborers. By contrast, when Baker CAC automated oil production products were employed in the mid-1990s to explore and automate Cainan Oil Field, a desert oilfield in Xinjiang, annual capacity for the field reached 1,500,000 tons, with only 400 employees needed to manage the oilfield. After the introduction of Baker CAC's products into China's petroleum industry, Chinese companies have also sought to provide automation solutions.

In the primary oil recovery stage, oil pressure in an oil reservoir may be high enough to force oil to the surface. Approximately 20% of oil may be harvested at this stage. The secondary oil recovery stage accounts for another 5% to 15% of oil recovery and involves such efforts as pumps to extract petroleum and the injection of water, natural gas, carbon dioxide or other gasses into the oil reservoir to force oil to the surface. Most oilfields in China have now entered into the tertiary stage of oil recovery, at which oil extraction becomes increasingly difficult and inefficient. Tertiary recovery generally focuses on decreasing oil viscosity to make extraction easier and accounts for between 5% and 15% of oil recovery. Our efforts in tertiary recovery focus on reducing water content in crude oil in order to make extraction more efficient.

Products and Services

We currently provide products and services to oil and gas field companies, which focus on the development and production of oil and natural gas. Our products and services described below correlate to the numbered stages of the oilfield production system graphical expression shown below.

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Our products and services include:

Equipment for Oil and Gas Production and Transportation

- *High-Efficiency Heating Furnaces (as shown above by process "6"). Crude petroleum contains certain impurities that must be removed before the petroleum can be sold, including water and natural gas. To remove the impurities and to prevent solidification and blockage in transport pipes, companies employ heating furnaces. BHD researched, developed and implemented a new oilfield furnace that is advanced, highly automated, reliable, easily operable, safe and highly heat-efficient (90% efficiency).*

- *Burner (as shown above by process "5"). We serve as an agent for the Unigas Burner which is designed and manufactured by UNIGAS, a European burning equipment production company. The burner we provide has the following characteristics: high degree of automation; energy conservation; high turn-down ratio; high security and environmental safety.*

Oil and Gas Production Improvement Techniques

- *Packers of Fracturing. This utility model is used concertedly with the security joint, hydraulic anchor, and slide bushing of sand spray in the well. It is used for easy seat sealing and sand-uptake prevention. The utility model reduces desilting volume and prevents sand uptake which makes the deblocking processes easier to realize. The back flushing is sand-stick proof.*

- *Production Packer. According to different withdraw points, the production packer separates different oil layers, and protects the oil pipe from sand and permeability, so as to promote the recovery ratio.*

- *Sand Prevention in Oil and Water Well. This technique processes additives that are resistant to elevated temperatures into "resin sand" which is transported to the bottom of the well via carrying fluid. The "resin sand" goes through the borehole, piling up and compacting at the borehole and oil vacancy layer. An artificial borehole wall is then formed, functioning as a means of sand prevention. This sand prevention technique has been adapted to more than 100 wells, including heavy oil wells, light oil wells, water wells and gas wells, with a 100% success rate and a 98% effective rate.*

- *Water Locating and Plugging Technique. High water cut affects the normal production of oilfields. Previously, there were no sophisticated method for water locating and tubular column plugging in China. The mechanical water locating and tubular column plugging technique we have developed resolves the problem of high water cut wells. This technique conducts a self-sealing-test during multi-stage usage and is reliable to separate different production sets effectively. The water location switch forms a complete process by which the water locating and plugging can be finished in one trip our tubular column is adaptable to several oil drilling methods and is available for water locating and plugging in second and third class layers.*

- *Fissure Shaper. This is our proprietary product that is used along with a perforating gun to effectively increase perforation depth by between 46% and 80%, shape stratum fissures, improve stratum diversion capability and, as a result, improve our ability to locate oilfields and increase the output of oil wells.*

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- *Fracture Acidizing. We inject acid to layers under pressure which can form or expand fissures. The treatment process of the acid is defined as fracture acidizing. The technique is mainly adapted to oil and gas wells that are blocked up relatively deeply, or the ones in the low permeable zones.*

- *Electronic Broken-down Service. This service resolves block-up and freezing problems by generating heat from the electric resistivity of the drive pipe and utilizing a loop tank composed of an oil pipe and a drive pipe. This technique saves energy and is environmentally friendly. It can increase the production of oilfields that are in the middle and later periods.*

Automation System and Service

- *Pumping Unit Controller. Refers to process "1" above. Functions as a monitor to the pumping unit, and also collects data for load, pressure, voltage, startup and shutdown control.*

- *RTU Used to Monitor Natural Gas Wells. Collects gas well pressure data.*

- *Wireless Dynamometer and Wireless Pressure Gauge. Refers to process "1" above. These products replace wired technology with cordless displacement sensor technology. They are easy to install and significantly reduce the working load associated with cable laying.*

- *Electric Multi-Way Valve for Oilfield Metering Station Flow Control. Refers to process "2" above. This multi-way valve is used before the test separator to replace the existing three valve manifolds. It facilitates the electronic control of the connection of the oil lead pipeline with the separator.*

- *Natural Gas Flow Computer System. Flow computer system used in natural gas stations and gas distribution stations to measure flow.*

- *Recon SCADA Oilfield Monitor and Data Acquisition System. Recon SCADA is a system which applies to the oil well, measurement station, and the union station for supervision and data collection.*

- *EPC Service of Pipeline SCADA System. A service technique for pipeline monitoring and data acquisition after crude oil transmission.*

- *EPC Service of Oil and Gas Wells SCADA System. A service technique for monitoring and data acquisition of oil wells and natural gas wells.*

- *EPC Service of Oilfield Video Surveillance and Control System. A video surveillance technique for controlling the oil and gas wellhead area and the measurement station area.*

- *Technique Service for "Digital Oilfield" Transformation. Includes engineering technique services such as oil and gas SCADA system, video surveillance and control system and communication systems.*

ISO9000 Certification

We have received ISO9000 certifications for several of our processes. The International Organization for Standardization consists of a worldwide federation of national standards bodies for approximately 130 countries, and the ISO9000 certification represents an international consensus of these standards bodies, with the aim of creating global standards of product and service quality. We have received ISO9000 certification for the following:

- Nanjing Recon has received certification for the development and service of *RSCADA*.

- BHD has received certification for high efficiency heating furnaces, import burners, and manometer surrogate rendition and service.

Customers

We operate our business by cooperating with oil companies and their subsidiaries, the petroleum administration bureau and local service companies. Most actual control of our direct and indirect clients can be traced to Sinopec and CNPC, the two major Chinese state-owned companies responsible for on-shore petroleum mining and extraction. We have conducted automation projects for plants in three of China's four highest producing oilfields, Daqing, Shengli and Xinjiang. We have undertaken the automation projects at the following locations, among others:

Sinopec

- Jiangsu Oil Field
- Shengli Oil Field
- The Northwest Division
- The Southwest Division
- Zhongyuan Oil Field
- Sichuan Oil Field
- Jianghan Oil Field

We provide products and services to Sinopec under a series of agreements, each of which is terminable without notice. We first began to provide services to Sinopec in 1998. Sinopec accounted for approximately 19.63% and 6.82% of our revenues for the fiscal years ended June 30, 2014 and 2015, respectively, and any termination of our business relationships with Sinopec would materially harm our operations.

CNPC

- Qinghai Oil Field
- Tuha Oil Field
- Daqing Oil Field
- Jidong Oil Field

- Sichuan Oil Field
- Xinjiang Oil Field
- Huabei Oil Field
- Jilin Oil Field

We provide products and services to CNPC under a series of agreements, each of which is terminable without notice. We first began to provide services to CNPC in 2000. CNPC accounted for approximately 42.79% and 43.09% of our revenues in the fiscal years ended June 30, 2014 and 2015, respectively, and any termination of our business relationships with CNPC would materially harm our operations.

In addition, BHD was recently qualified as a Class A Furnace Supplier for PetroChina's oil field companies, which allows us to participate in bidding as a supplier for PetroChina. Since obtaining the Class A Furnace Supplier qualification in December 2015, we have been awarded three contracts, including contracts to supply furnaces and furnace components to PetroChina's companies in the Huabei Oil Field and Jilin Oil Field.

Our Strengths

- *Safety of products. The automation projects we have conducted have demonstrated that our products are reliable, safe and effective at automating the petroleum extraction process.*
- *Efficiency of technology. We believe our technology increases efficiency and profitability for petroleum companies by enabling them to monitor, manage and control petroleum extraction; increase the amount of petroleum extracted and reduce impurities in extracted petroleum.*

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- *Ability to leverage our knowledge of Chinese business culture. Many of our competitors are based outside of China. As the Domestic Companies are based in China, we are in a unique position to emphasize Chinese culture and business knowledge to obtain new customers and new agreements with existing customers. We believe that many Chinese businesses, including state-owned companies like Sinopec and CNPC, would prefer to hire a Chinese company to assist in their business operations if a Chinese company exists with the ability to fulfill their needs on a timely and cost-efficient basis. In addition, our knowledge of Chinese culture allows us to anticipate and adapt to Chinese oilfield management methods. We provide our software solutions in Mandarin for the benefit of our Chinese customers, and all of our customer support is available from Mandarin fluent personnel.*

- *Experienced, successful executive management team. Our executive management team has significant experience and success in the petroleum automation industry. They will be able to draw on their knowledge of the industry and their relationships in the industry.*

- *Ability to leverage China's cost structure. As a Chinese company, we believe we can operate our business more cost-effectively because all of our employees, operations and assets are located in China, resulting in lower labor, development, manufacturing and rent costs than we believe we would incur if we also maintained operations abroad. We expect these costs savings will be reflected in lower costs to our customers for comparable products.*

- *Ownership of our intellectual property. Because we own our intellectual property, we are able to avoid licensing fees or contravening licensing agreements.*

Our Strategies

Our goal is to help our customers improve their efficiency and profitability by providing them with software and hardware solutions and services to improve their ability to locate productive oil reservoirs, manage the oil extraction process, reduce extraction costs, and enhance recovery from extraction activities. Key elements of our strategies include:

- *Increase our market share in China. We believe that as the Chinese economy and oil industry continue to develop, Chinese petroleum extraction automation companies will compete with international businesses at an increasing rate. Consequently, we believe we will have opportunities to take market share from foreign companies by developing positive business relationships in China's petroleum mining and extraction industry. We will also use strategic advertisements, predominantly in China's northeast and northwest, where China's major oilfields are located, to increase our brand awareness and market penetration. We aim to continue developing new technologies designed to improve petroleum mining and extraction efficiency and profitability for our customers.*

- *Develop our own branded products and services and shift our focus away from trading business. Our management believes in the importance of our own branded products and our services, in light of their higher profit margins and* *their long-term significance in establishing the status of our Company in the oil and gas industry. Moreover, the trading business relies on the major clients' procurement policies toward agencies, any significant change of which could jeopardize our operating results. Our management therefore believes that in the long run we will need to focus our growth strategy in developing professional services for the oil and gas industry in China.*

- *Focus on higher-profit subsection of market. While we plan to continue to provide services to all of our clients, we believe that we may improve our profit margins by focusing a higher portion of our advertising and promotions at those sub-divisions of our industry that have traditionally held the highest profit margins.*

- *Offer services to foreign oilfields contracted by Chinese petroleum companies. As Sinopec and CNPC continue to invest in oilfields in other countries, we will focus on offering our services in these new locations based on our success in working with the companies in China.*

- *Seek opportunities with foreign companies in China. Even where oilfields in China are partially operated by foreign companies, a significant number of employees will be Chinese and will benefit from our Chinese-language services. We believe our hardware and software solutions would be beneficial to any petroleum company doing business in China and plan to continue marketing to foreign companies entering the Chinese market.*

- *Provide services that generate high customer satisfaction levels. Chinese companies in our market are strongly influenced by formal and informal referrals. We believe that we have the opportunity to expand market share by providing high levels of customer satisfaction with our current customers, thereby fostering strong customer referrals to support sales activities.*

Competition

We face competition from a variety of foreign and domestic companies involved in the petroleum mining automation industry. While we believe we effectively compete in our market, our competitors hold a substantial market share.

A few of our existing competitors, as well as a number of potential new competitors, have significantly greater financial, technical, marketing and other resources than we do, which could provide them with a significant competitive advantage over us. We cannot guarantee that we will be able to compete successfully against our current or future competitors in our industry or that competition will not have a material adverse effect on our business, operating results and financial condition.

Our primary domestic competitors include the following:

- *Beijing Echo Technologies Development Co., Ltd. ("BET"). BET provides a combination of software and hardware products for industrial automatic control systems in the petroleum industry. BET currently engages in research and development of software and hardware applied to industrial automatic control systems, manufacturing and installation of industrial automation instruments and integration of automatic control products.*

- *Beijing Golden-Time Petroleum Measurement Technology Co., Ltd. ("BGT"). BGT develops analysis software used in oilfields but does not yet, to our knowledge, produce a substantial amount of hardware products.*

- *Anton Oilfield Services Group (HKEx stock code: 3337) is a leading independent oilfield services provider offering one-stop oil and gas field technical development services to oil companies. Its services and solutions span across the drilling technology, well completion, down-hole operation, and oil production phases in the development cycle. Its fast growth benefits from the accelerated development of natural gas in China and the Group's increased presence in the overseas markets.*

Research and Development

We focus our research and development efforts on improving our development efficiency and the quality of our products and services. As of June 30, 2015, our research and development team consisted of 41 experienced engineers, developers and programmers. In addition, some of our support employees regularly participate in our research and development programs.

In the fiscal years ended June 30, 2015 and 2014, we spent approximately ¥4.2 million ($0.7 million) and ¥8.1 million ($1.3 million), respectively, on research and development activities.

Intellectual Property

Our success and competitive position is dependent in part upon our ability to develop and maintain the proprietary aspect of our technology. The reverse engineering, unauthorized copying, or other misappropriation of our technology could enable third parties to benefit from our technology without paying for it. We rely on a combination of trademark, trade secret, copyright law and contractual restrictions to protect the proprietary aspects of the Domestic Companies' and our technology. We seek to protect the source code to the Domestic Companies' and our software, documentation and other written materials under trade secret and copyright laws. While we actively take steps to protect the Domestic Companies' and our proprietary rights, such steps may not be adequate to prevent the infringement or misappropriation of the Domestic Companies' and our intellectual property. This is particularly the case in China where the laws may not protect our proprietary rights as fully as in the United States.

We license the Domestic Companies' and our software products under signed license agreements that impose restrictions on the licensee's ability to utilize the software and do not permit the re-sale, sublicense or other transfer of the software. Finally, we seek to avoid disclosure of the Domestic Companies' and our intellectual property by requiring employees and independent consultants to execute confidentiality agreements.

Although we develop our software products, in conjunction with the Domestic Companies, each software product is based upon middleware developed by third parties. We integrate this technology, licensed by our customers from third parties, in our software products. If our customers are unable to continue to license any of this third party software, or if the third party licensors do not adequately maintain or update their products, we would face delays in the releases of our software until equivalent technology can be identified, licensed or developed, and integrated into our software products. These delays, if they occur, could harm our business, operating results and financial condition.

There has been a substantial amount of litigation in the software industry regarding intellectual property rights. It is possible that in the future third parties may claim that our current or potential future software solutions infringe their intellectual property. We expect that software product developers will increasingly be subject to infringement claims as the number of products and competitors in our industry segment grows and the functionality of products in different industry segments overlap. In addition, we may find it necessary to initiate claims or litigation against third parties for infringement of our proprietary rights or to protect our trade secrets. Although, along with the Domestic Companies, we may disclaim certain intellectual property representations to our customers, these disclaimers may not be sufficient to fully protect us against such claims. Any claims, with or without merit, could be time consuming, result in costly litigation, cause product shipment delays or require the Domestic Companies and us to enter into royalty or license agreements. Royalty or licensing agreements, if required, may not be available on terms acceptable to us or at all, which could have a material adverse effect on our business, operating results and financial condition.

Our standard software license agreements contain an infringement indemnity clause under which we agree to indemnify and hold harmless our customers and business partners against liability and damages arising from claims of various copyright or other intellectual property infringement by the Domestic Companies' and our products. We have never lost an infringement claim, and our costs to defend such lawsuits have been insignificant. Although it is possible that in the future third parties may claim that our current or potential future software solutions or we infringe on their intellectual property, we do not currently expect a significant impact on our business, operating results, or financial condition.

We market our products under the following trademarks which are registered with the PRC Trademark Bureau under the State Administration for Industry and Commerce. We currently own or have applied for the following trademarks:

1. Trademark of "BHD" valid from November 7, 2003 through November 6, 2023;

2. Trademark of "Recon" of the 7th classification valid from October 21, 2011 through October 20, 2021;

3. Trademark of "Recon" of the 9th classification valid from April 21, 2011 through April 20, 2021; and

4. Trademark of “Recon” of the 42nd classification valid from September 7, 2011 through September 6, 2021.

We currently own or have applied for the following 25 patents registered with the State Intellectual Property Office which are applied on our automated products and heating related equipment for the petroleum industry:

1. Patent of fracturing packer valid until August 5, 2018;

2. Patent of pressure phase transition furnace valid until August 5, 2018;

3. Patent of vacuum furnace phase transition heater valid until August 5, 2018;

4. Patent of high pressure natural gas water heater valid until June 30, 2019;

5. Patent of negative pressure heater valid until June 30, 2019;

6. Patent of water jacket furnace valid until June 30, 2019;

7. Patent of tube heating furnace valid until June 30, 2019;

8. Patent of automatically adjusting negative pressure burner valid until August 5, 2019;

9. Patent of wireless data instrument diagram valid until December 10, 2018;

10. Patent of hot water furnace valid until April 8, 2021;

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11. Patent of multifunctional heating furnace valid until April 8, 2021;

12. Patent of efficient gas-liquid separator valid until August 15, 2021;

13. Patent of efficient oil-gas-water separator valid until October 24, 2021;

14. Patent of room pressure pipeline heater valid until October 24, 2021;

15. Patent of pneumatic control system valid until February 9, 2022;

16. Patent of firebox indirect heating furnace valid until December 14, 2022;

17. Patent of cylindrical-tubular furnace valid until December 14, 2022;

18. Patent of horizontal type furnace valid until December 14, 2022;

19. Patent of vertical type furnace valid until December 13, 2022;

20. Patent of vacuum furnace valid until December 14, 2022;

21. Patent of wireless pressure sensor valid until November 11, 2023;

22. Patent of wireless start-end module valid until November 11, 2023; and

23. Four more patent applications have been submitted and are pending approval.

We have registered the following software products with the State Intellectual Property Office:

1. Recon automated monitoring system version 1 was published on July 30, 2011;

2. Recon automated maintenance and production-management system version 1 was published on July 10, 2011;

3. Recon SCADA field monitoring and data acquisition system software version 4 was published on January 28, 2011;

4. Recon flow control computer monitoring system software was registered and published on February 8, 2008;

5. Recon SCADA field monitoring and data acquisition system software version 2 was published on August 18, 2003, and version 3 was registered and published on April 5, 2008;

6. Recon wireless field monitoring and data acquisition system software version 2 was published on January 8, 2011, and version 1 was registered and published on September 15, 2010;

7. Recon RCNAMT version 1 was published on April 27, 2012; and

8. Recon Process Auto version 1 was published on August 25, 2012.

Environmental Matters

We have not incurred material expenses in connection with compliance with Chinese environmental laws and regulations. We do not anticipate expending any material amounts for such compliance purposes for the remainder of our current or succeeding fiscal year.

China's Intellectual Property Rights Enforcement System

In 1998, China established the State Intellectual Property Office ("SIPO") to coordinate China's intellectual property enforcement efforts. SIPO is responsible for granting and enforcing patents, as well as coordinating intellectual property rights related to copyrights and trademarks. Protection of intellectual property in China follows a two-track system. The first track is administrative in nature, whereby a holder of intellectual property rights files a complaint at a local administrative office. Determining which intellectual property agency can be confusing, as jurisdiction of intellectual property matters is diffused throughout a number of government agencies and offices, with each typically responsible for the protection afforded by one statute or one specific area of intellectual property-related law. The second track is a judicial track, whereby complaints are filed through the Chinese court system. Since 1993, China has maintained various intellectual property tribunals. The total volume of intellectual property related litigation, however, remains small.

Although there are differences in intellectual property rights between the United States and China, of most significance to the Company is the inexperience of China in connection with the development and protection of intellectual property rights. Similar to the United States, China has chosen to protect software under copyright law rather than trade secrets, patent or contract law. As such, we will attempt to protect our most significant intellectual property pursuant to Chinese laws that have only recently been adopted. Unlike the United States, which has lengthy case law related to the interpretation and applicability of intellectual property law, China has a less developed body of relevant intellectual property case law.

Regulation on Software Products

On March 1, 2009, the Ministry of Industry and Information Technology of China issued the Administrative Measures on Software Products, or the Software Measures, which became effective as of April 10, 2009, to strengthen the regulation of software products and to encourage the development of the Chinese software industry. Under the Software Measures, a software developer must have all software products imported into or sold in China tested by a testing organization supervised by the Ministry of Industry and Information Technology. The software industry authorities in provinces, autonomous regions, municipalities and cities with independent planning are in charge of the registration, report and management of software products. Software products can be registered for five years, and the registration is renewable upon expiration. Although some of Nanjing Recon's current software products were registered in 2008, there can be no guarantee that the registration will be renewed in 2013 or that the Domestic Companies' and our future products will be registered.

Regulation of Intellectual Property Rights

China has adopted legislation governing intellectual property rights, including trademarks and copyrights. China is a signatory to the main international conventions on intellectual property rights and became a member of the Agreement on Trade Related Aspects of Intellectual Property Rights upon its accession to the WTO in December 2001.

Copyright. China adopted its first copyright law in 1990. The National People's Congress amended the Copyright Law in 2001 to widen the scope of works and rights that are eligible for copyright protection. The amended Copyright Law extends copyright protection to software products, among others. In addition, there is a voluntary registration system administered by the China Copyright Protection Center. Unlike patent and trademark registration, copyrighted works do not require registration for protection. Protection is granted to individuals from countries belonging to the copyright international conventions or bilateral agreements of which China is a member. Nanjing Recon has ten copyrights for software programs.

Trademark. The Chinese Trademark Law, adopted in 1982 and revised in 1993 and 2001, protects registered trademarks. The Trademark Office under the Chinese State Administration for Industry and Commerce handles trademark registrations and grants a term of ten years to registered trademarks. Trademark license agreements must be filed with the Trademark Office for record. China has a "first-to-register" system that requires no evidence of prior use or ownership. The Domestic Companies and we have registered a number of product names with the Trademark Office.

Regulations on Foreign Exchange

Foreign Currency Exchange. Under the PRC foreign exchange regulations, payments of current account items, such as profit distributions and trade and service-related foreign exchange transactions, may be made in foreign currencies without prior approval from SAFE by complying with certain procedural requirements. By contrast, approval from or registration with appropriate government authorities is required where RMB is to be converted into foreign currency and remitted out of China to pay capital expenses such as the repayment of foreign currency-denominated loans or foreign currency is to be remitted into China under the capital account, such as a capital increase or foreign currency loans to our PRC subsidiaries.

SAFE issued the Circular on the Relevant Operating Issues Concerning the Improvement of the Administration of the Payment and Settlement of Foreign Currency Capital of Foreign-Invested Enterprises (2008), or SAFE Circular 142, regulating the conversion by a foreign-invested enterprise of foreign currency-registered capital into RMB by restricting how the converted RMB may be used. In addition, SAFE promulgated Circular 45 on November 9, 2011 in order to clarify the application of SAFE Circular 142. Under SAFE Circular 142 and Circular 45, the RMB capital converted from foreign currency registered capital of a foreign-invested enterprise may only be used for purposes within the business scope approved by the applicable government authority and may not be used for equity investments within the PRC. In addition, SAFE strengthened its oversight of the flow and use of the RMB capital converted from foreign currency registered capital of foreign-invested enterprises. The use of such RMB capital may not be changed without SAFE's approval, and such RMB capital may not in any case be used to repay RMB loans if the proceeds of such loans have not been used.

Since SAFE Circular 142 has been in place for more than five years, SAFE decided to further reform the foreign exchange administration system in order to satisfy and facilitate the business and capital operations of foreign invested enterprises, and issued the Circular on the Relevant Issues Concerning the Launch of Reforming Trial of the Administration Model of the Settlement of Foreign Currency Capital of Foreign-Invested Enterprises in Certain Areas on August 4, 2014. This circular suspends the application of SAFE Circular 142 in certain areas and allows a foreign-invested enterprise registered in such areas with a business scope including "investment" to use the RMB capital converted from foreign currency registered capital for equity investments within the PRC.

SAFE promulgated Circular 59 in November 2010, which tightens the regulation over settlement of net proceeds from overseas offerings, such as our initial public offering, and requires, among other things, the authenticity of settlement of net proceeds from offshore offerings to be closely examined and the net proceeds to be settled in the manner described in the offering documents or otherwise approved by our board. Violations of these SAFE regulations may result in severe monetary or other penalties, including confiscation of earnings derived from such violation activities, a fine of up to 30% of the RMB funds converted from the foreign invested funds or in the case of a severe violation, a fine ranging from 30% to 100% of the RMB funds converted from the foreign-invested funds.

In November 2012, SAFE promulgated the Circular of Further Improving and Adjusting Foreign Exchange Administration Policies on Foreign Direct Investment, which substantially amends and simplifies the current foreign exchange procedure. Pursuant to this circular, the opening of various special purpose foreign exchange accounts, such as pre-establishment expenses accounts, foreign exchange capital accounts and guarantee accounts, the reinvestment of RMB proceeds by foreign investors in the PRC, and remittance of foreign exchange profits and dividends by a foreign-invested enterprise to its foreign shareholders no longer require the approval or verification of SAFE, and multiple capital accounts for the same entity may be opened in different provinces, which was not possible previously. In addition, SAFE promulgated the Circular on Printing and Distributing the Provisions on Foreign Exchange Administration over Domestic Direct Investment by Foreign Investors and the Supporting Documents in May 2013, which specifies that the administration by SAFE or its local branches over direct investment by foreign investors in the PRC shall be conducted by way of registration and banks shall process foreign exchange business relating to the direct investment in the PRC based on the registration information provided by SAFE and its branches.

Regulation of Dividend Distribution. The principal regulations governing the distribution of dividends by foreign holding companies include the Foreign Investment Enterprise Law (1986), as amended, and the Administrative Rules under the Foreign Investment Enterprise Law (2001).

Under these regulations, foreign investment enterprises in China may pay dividends only out of their retained profits, if any, determined in accordance with PRC accounting standards and regulations. In addition, foreign investment enterprises in China are required to allocate at least 10% of their respective retained profits each year, if any, to fund certain reserve funds unless these reserves have reached 50% of the registered capital of the enterprises. These reserves are not distributable as cash dividends.

SAFE Circular 37, on July 4, 2014, which replaced the former circular commonly known as “SAFE Circular 75” promulgated by SAFE on October 21, 2005. SAFE Circular 37 requires PRC residents to register with local branches of SAFE in connection with their direct establishment or indirect control of an offshore entity, for the purpose of overseas investment and financing, with such PRC residents’ legally owned assets or equity interests in domestic enterprises or offshore assets or interests, referred to in SAFE Circular 37 as a “special purpose vehicle.” SAFE Circular 37 further requires amendment to the registration in the event of any significant changes with respect to the special purpose vehicle, such as increase or decrease of capital contributed by PRC individuals, share transfer or exchange, merger, division or other material event. In the event that a PRC shareholder holding interests in a special purpose vehicle fails to fulfill the required SAFE registration, the PRC subsidiaries of that special purpose vehicle may be prohibited from making profit distributions to the offshore parent and from carrying out subsequent cross-border foreign exchange activities, and the special purpose vehicle may be restricted in its ability to contribute additional capital into its PRC subsidiary. Furthermore, failure to comply with the various SAFE registration requirements described above could result in liability under PRC law for evasion of foreign exchange controls.

Regulations on Foreign Investment in Automation Service Industry and Oil Exploration and Extraction Industry in PRC. In accordance with the Catalogue of Industries for Guiding Foreign Investment (Revised 2007), the oil and gas automation service industries are in the catalogue of permitted industries, and thus there are no restrictions on foreign investment in the oil and gas automation industry. In addition the following industries are encouraged for foreign investment in China:

- Manufacturing of equipment for oil exploration, drilling, collection and transportation: floating drilling systems and floating production systems with an operating water depth of more than 1,500 meters and the supporting subsea oil extraction, collection and transportation equipment
- Exploration and exploitation of oil and natural gas with venture capital (limited to equity joint ventures and cooperative joint ventures);
- Development and application of new technologies that increase the recovery ratio of crude oil (limited to equity joint ventures and cooperative joint ventures);
- Development and application of new oil exploration and exploitation technologies such as geophysical exploration, drilling, well logging, and downhole operation, etc. (limited to cooperative joint ventures); and
- Exploration and development of unconventional oil resources such as oil shale, oil sands, heavy oil, and excess oil (limited to cooperative joint ventures).

Employees

As of April 25, 2016, we had 80 employees, all of whom were based in China. Of the total, 12 were in management, 38 were in technical support and research and development, 13 were engaged in sales and marketing, 11 were in financial affairs, and six were in administration and procurement. We believe that our relations with our employees are good. We have never had a work stoppage and our employees are not subject to a collective bargaining agreement.

Insurance

We do not have any business interruption, litigation or natural disaster insurance coverage for our operations in China. Insurance companies in China offer limited business insurance products. While business interruption insurance is available to a limited extent in China, we have determined that the risks of interruption, cost of such insurance and the difficulties associated with acquiring such insurance on commercially reasonable terms make it impractical for us to have such insurance. Therefore, we are subject to business and product liability exposure. Business or product liability claims or potential regulatory actions could materially and adversely affect our business and financial condition.

We do, however, pay certain required insurance amounts in connection with our employees' wages. The amount and types of insurance we must provide under Chinese and local requirements vary by the location of each of the Domestic Companies. The following table summarizes the types of insurance paid for each of the Domestic Companies:

Nanjing Recon

Housing Fund

Pension

Unemployment Insurance

Medical Insurance

Occupational Injury Insurance

Maternity Insurance

BHD

Pension

Unemployment Insurance

Medical Insurance

Occupational Injury Insurance

PROPERTIES

We currently operate in three facilities throughout China. Our headquarters are located in Beijing.

Office	**Address**	**Lease Term**	**Space**
Headquarters	Room 1902, Building C King Long International Mansion, Chaoyang District Beijing, PRC	July 1, 2015 to June 30, 2016	220 square meters
Nanjing Recon	Room 310 and 311, No. 2 BuildingChuqiaocheng, No. 47 Andemen Street Yu Hua District Nanjing City, PRC	April 1, 2016 to March 31, 2017	565 square meters
BHD	18 th Floor, Building C King Long International Mansion, Chaoyang District Beijing, PRC	January 1, 2016 to December 31, 2016	450 square meters
	West building, Zhengfu Street, Huoying Changping District, PRC	January 1, 2016 to December 31, 2016	900 square meters

LEGAL PROCEEDINGS

From time to time, we may become involved in various lawsuits and legal proceedings, which arise in the ordinary course of business. Nonetheless, any litigation is subject to inherent uncertainties, and an adverse result in these or other matters may arise from time to time that may harm our business. We are currently not aware of any such pending or threatened legal proceedings, claims, regulatory inquires or investigations that we believe will have a material adverse effect on our business, financial condition or operating results.

MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

(a) Market for Our Ordinary Shares

We completed our initial public offering on July 29, 2009. The following table sets forth the quarterly high and low sale prices for our ordinary shares as reported on the NASDAQ Capital Market.

	High	Low
Year Ended June 30, 2016		
Quarter Ended September 30, 2016	$ 1.68	$ .63
Quarter Ended December 31, 2016	$ 2.13	$ .85
Quarter Ended March 31, 2016	$ 1.64	$ 1.21
Year Ended June 30, 2015		
Quarter Ended September 30, 2014	$ 5.38	$ 3.46
Quarter Ended December 31, 2014	$ 5.47	$ 1.93
Quarter Ended March 31, 2015	$ 3.20	$ 1.27
Quarter Ended June 30, 2015	$ 2.95	$ 1.50
Year Ended June 30, 2014		
Quarter Ended September 30, 2013	$ 2.43	$ 1.75
Quarter Ended December 31, 2013	$ 5.80	$ 2.18
Quarter Ended March 31, 2014	$ 8.00	$ 3.07
Quarter Ended June 30, 2014	$ 5.62	$ 3.22

As of June 30, 2015, there were approximately seven holders of record of our ordinary shares. This excludes our ordinary shares owned by shareholders holding ordinary shares under nominee security position listings. On June 30, 2015, the last sales price of our ordinary shares as reported on the NASDAQ Capital Market was $1.50 per ordinary share.

Dividend Policy

We have never declared or paid any cash dividends on our ordinary shares. We anticipate that we will retain any earnings to support operations and to finance the growth and development of our business. Therefore, we do not expect to pay cash dividends in the foreseeable future. Any future determination relating to our dividend policy will be made at the discretion of our Board of Directors and will depend on a number of factors, including future earnings, capital requirements, financial conditions and future prospects and other factors the Board of Directors may deem relevant.

Because we are a holding company with no operations of our own and all of our operations are conducted through our Chinese subsidiary, our ability to pay dividends and to finance any debt that we may incur is dependent upon dividends and other distributions paid. In addition, Chinese legal restrictions permit payment of dividends to us by our Chinese subsidiary only out of its accumulated net profit, if any, determined in accordance with Chinese accounting standards and regulations. Under Chinese law, our subsidiary is required to set aside a portion (at least 10%) of its after-tax net income (after discharging all cumulated loss), if any, each year for compulsory statutory reserve until the amount of the reserve reaches 50% of our subsidiaries' registered capital. These funds may be distributed to shareholders at the time of its wind up. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Holding Company Structure."

Payments of dividends by our subsidiary in China to the Company are also subject to restrictions including primarily the restriction that foreign invested enterprises may only buy, sell and/or remit foreign currencies at those banks authorized to conduct foreign exchange business after providing valid commercial documents. There are no such similar foreign exchange restrictions in the Cayman Islands.

(b) We are not required to provide any disclosure under this item, as we have applied all of the net proceeds from our initial public offering, as disclosed in our annual report on Form 10-K for the year ended June 30, 2011. While we have filed a shelf registration statement on Form S-3 (SEC no. 333-190387, declared effective August 14, 2013), we have sold 546,500 shares under such registration statement.

(c) None.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

AND RELATED STOCKHOLDER MATTERS

The following table sets forth information with respect to beneficial ownership of our ordinary shares as of the date of this report, for each person known by us to beneficially own 5% or more of our ordinary shares, and all of our executive officers and directors individually and as a group. Beneficial ownership is determined in accordance with the rules of the SEC and includes voting or investment power with respect to the securities. Except as indicated below, and subject to applicable community property laws, the persons named in the table have sole voting and investment power with respect to all ordinary shares shown as beneficially owned by them. Percentage of beneficial ownership is based on 6,265,125 Shares, which consists of 5,804,005 Shares outstanding as of April 25, 2016 and 461,120 shares subject to options that are exercisable within 60 days after April 25, 2016. Such shares subject to options are deemed to be outstanding for the purposes of computing the percentage ownership of the individual holding such shares, but are not deemed outstanding for purposes of computing the percentage for any other person shown in the table. Our major shareholders do not possess voting rights that differ from our other shareholders. The address of each of the below shareholders is c/o Recon Technology Ltd, Room 1902, Building C, King Long International Mansion, 9 Fulin Road, Beijing 100107 China.

	Amount of Beneficial Ownership	Percentage Ownership	
Yin Shenping (1)	857,215	13.68	%
Chen Guangqiang (2)	799,881	12.77	%
Hu Jijun (3)	15,000	*	%
Nelson Wong (4)	18,000	*	%
Zhao Shudong (5)	12,000	*	%
Liu Jia (6)	50,000	*	%
Liu Hui (7)	833,681	13.31	%
Chen Yiquan (7)	833,681	13.31	%
Total	2,585,777	41.27	%
Directors and Executive Officers as a Group (seven members)	1,752,096	27.97	%

(1) Includes 92,000 options to purchase ordinary shares that were exercisable and 81,727 stock award that were vested and to be vested within 60 days after April 25, 2016. Does not include 16,000 options that were not exercisable within 60 days after April 25, 2016.

(2) Includes 70,000 options to purchase ordinary shares that were exercisable and 95,060 stock award that were vested and to be vested within 60 days after April 25, 2016. Does not include 10,000 options that were not exercisable within 60 days after April 25 , 2016

(3) Includes 23,333 options to purchase ordinary shares that were exercisable within 60 days after April 25, 2016.

(4) Includes 26,333 options to purchase ordinary shares that were exercisable within 60 days after April 25, 2016.

(5) Includes12,000 options that were not exercisable within 60 days after April 25, 2016.

(6) Includes 60,667 options to purchase ordinary shares that were exercisable within 60 days after February 16, 2016.

(7) Includes 458,525 Shares held by Chen Yiquan and 375,156 Shares held by Liu Hui. According to a jointly filed Schedule 13D dated December 27, 2010 (Accession No. 0001144204-10-068264), Chen Yiquan and Liu Hui share beneficial ownership of and have joint voting and dispositive power over the aggregate 833,681 Shares.

* Less than 1%.

DESCRIPTION OF CAPITAL STOCK

General

Our authorized capital stock consists of 100,000,000 ordinary shares, par value $0.0185 per share. As of April 25, 2016, 5,804,005 ordinary shares were issued and outstanding. As of April 25, 2016, we have issued options to purchase, in the aggregate, 816,500 ordinary shares of our company.

Ordinary Shares

Holders of ordinary shares are entitled to cast one vote for each share on all matters submitted to a vote of stockholders, including the election of directors. The holders of ordinary shares are entitled to receive ratably such dividends, if any, as may be declared by the board of directors out of funds legally available therefor and subject to any preference of any then authorized and issued preferred shares. See “Dividend Policy.” Such holders do not have any preemptive or other rights to subscribe for additional shares. All holders of ordinary shares are entitled to share ratably in any assets for distribution to shareholders upon the liquidation, dissolution or winding up of the Company, subject to any preference of any then authorized and issued preferred shares. There are no conversion, redemption or sinking fund provisions applicable to the ordinary shares. All outstanding ordinary shares are fully paid and nonassessable.

Limitations on the Right to Own Shares

There are no limitations on the right to own our ordinary shares.

Limitations on Transfer of Shares

Our Second Amended and Restated Articles of Association give our directors, at their discretion, the right to decline to register any transfer of shares.

Disclosure of Shareholder Ownership

There are no provisions in our Second Amended and Restated Memorandum of Association or Second Amended and Restated Articles of Association governing the ownership threshold above which shareholder ownership must be disclosed.

Changes in Capital

We may from time to time by ordinary resolution increase the share capital by such sum, to be divided into shares of such amount, as the resolution shall prescribe. The new shares shall be subject to the same provisions with reference to the payment of calls, lien, transfer, transmission, forfeiture and otherwise as the shares in the original share capital. We may by ordinary resolution:

- consolidate and divide all or any of our share capital into shares of larger amount than our existing shares;
- convert all or any of our paid up shares into stock and reconvert that stock into paid up shares of any denomination;

- in many circumstances, sub-divide our existing shares, or any of them, into shares of smaller amount provided that in the subdivision the proportion between the amount paid and the amount, if any, unpaid on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived; and
- cancel any shares which, at the date of the passing of the resolution, have not been taken or agreed to be taken by any person and diminish the amount of its share capital by the amount of the shares so cancelled.

We may by special resolution reduce our authorized but unissued share capital and any capital redemption reserve fund in any manner authorized by law.

Differences in Corporate Law

The Cayman Islands Companies Law is modeled after English law but does not follow many recent English law statutory enactments. In addition, the Companies Law differs from laws applicable to United States corporations and their shareholders. Set forth below is a summary of the significant differences between the provisions of the Companies Law applicable to us and, for comparison purposes, the laws applicable to companies incorporated in the State of Delaware and their shareholders.

Mergers and similar arrangements

Historically, Cayman Islands law did not provide for mergers as that expression is understood under United States corporate law and prior to the enactment of the Companies Law (2009 Revision) the statutory provisions that facilitated the reconstruction and amalgamation of companies, provided that the arrangement had to be approved by a majority in number of each class of shareholders and creditors with whom the arrangement was to be made, and who must in addition represent three-fourths in value of each such class of shareholders or creditors, as the case may be, and subsequently the arrangement had to be sanctioned by the Grand Court of the Cayman Islands.

A new Part XVA has been added to the Companies Law (2009 Revision) to streamline the process of merger and consolidation of Cayman Islands companies, without court approval. The primary characteristics of merger or consolidation under Cayman Law include:

a plan of merger or consolidation must be approved by (i) a shareholder resolution of each constituent company by a majority in number representing 75% in value of all shareholders voting together as one class; and (ii) if the shares in the consolidated or surviving company are to have the same rights and economic value as the shares held in each constituent company, a special resolution of all shareholders voting together as one class (in both cases shares which carry no voting rights can vote on the plan). This requirement does not apply if a parent company is seeking to merge with one or more subsidiaries (the parent must own 90% of each voting share class of the subsidiary), in which case a copy of the plan only needs be circulated to all shareholders; and

a plan of merger or consolidation must be signed by one director of each constituent company, along with a director's declaration confirming, among other matters, post-merger/consolidation solvency, bona fide motives behind the merger/consolidation, that the merger/consolidation is not intended to defraud unsecured creditors, the absence of adverse court proceedings or other such matters along with a list of assets and liabilities.

When a take-over offer is made and accepted (within four months) by holders of not less than 90.0% of the shares affected, the offeror may, within a two month period, require the holders of the remaining shares to transfer such shares on the terms of the offer. An objection can be made to the Grand Court of the Cayman Islands but this is unlikely to succeed unless there is evidence of fraud, bad faith or collusion. If the arrangement and reconstruction is thus approved, the dissenting shareholder would have no rights comparable to appraisal rights, which would otherwise ordinarily be available to dissenting shareholders of a Delaware corporation, providing rights to receive payment in cash for the judicially determined value of the shares.

Shareholders' suits

We are not aware of any reported class action or derivative action having been brought in a Cayman Islands court. In principle, the Company itself will normally be the proper plaintiff in actions against directors, and derivative actions may not generally be brought by a minority shareholder. However, based on English authorities, who would in all likelihood be of persuasive authority in the Cayman Islands, there are exceptions to the foregoing principle, including when:

- a company acts or proposes to act illegally or ultra vires;

- the act complained of, although not ultra vires, required a special resolution, which was not obtained; and
- those who control the company are perpetrating a "fraud on the minority."

Directors' fiduciary duties

Under Delaware corporate law, a director of a Delaware corporation has a fiduciary duty to the corporation and its shareholders. This duty has two components: the duty of care and the duty of loyalty. The duty of care requires that a director act in good faith, with the care that an ordinarily prudent person would exercise under similar circumstances. Under this duty, a director must inform himself of, and disclose to shareholders, all material information reasonably available regarding a significant transaction. The duty of loyalty requires that a director act in a manner he reasonably believes to be in the best interests of the corporation. He must not use his corporate position for personal gain or advantage. This duty prohibits self-dealing by a director and mandates that the best interest of the corporation and its shareholders take precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the shareholders generally. In general, actions of a director are presumed to have been made on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the corporation. However, this presumption may be rebutted by evidence of a breach of one of the fiduciary duties. Should such evidence be presented concerning a transaction by a director, a director must prove the procedural fairness of the transaction, and that the transaction was of fair value to the corporation.

In contrast, as matter of Cayman Islands law, a director of a Cayman Islands company is in the position of a fiduciary with respect to the company and therefore it is considered that the director owes the following duties to the company – a duty to act bona fide in the best interests of the company, a duty not to make a profit out of his position as director (unless the company permits him to do so) and a duty not to put himself in a position where the interests of the company conflict with his personal interest or his duty to a third-party. A director of a Cayman Islands company owes to the company a duty to act with skill and care. It was previously considered that a director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience. However, English and Commonwealth courts have moved towards an objective standard with regard to the required skill and care and these authorities are likely to be followed in the Cayman Islands.

Shareholder action by written consent

Under the Delaware General Corporation Law, a corporation may eliminate the right of shareholders to act by written consent by amendment to its certificate of incorporation. Under Cayman Islands law, however, and our articles of association, shareholders may approve corporate matters by way of a unanimous written resolution signed by or on behalf of each shareholder who would have been entitled to vote on such matter at a general meeting without a meeting being held.

Shareholder proposals

Under the Delaware General Corporation Law, a shareholder has the right to put any proposal before the annual meeting of shareholders, provided it complies with the notice provisions in the governing documents. A Annual Meeting may be called by the board of directors or any other person authorized to do so in the governing documents, but shareholders may be precluded from calling Annual Meetings. Under Cayman Islands law, as well as our articles of association, stockholders holding not less than 10% of the paid up voting share capital of the Company to requisition a stockholder's meeting. As an exempted Cayman Islands company, we are not obliged by law to call stockholders' annual general meetings. However, our articles of association require us to call such meetings.

Cumulative voting

Under the Delaware General Corporation Law, cumulative voting for elections of directors is not permitted unless the corporation's certificate of incorporation specifically provides for it. Cumulative voting potentially facilitates the representation of minority shareholders on a board of directors since it permits the minority shareholder to cast all the votes to which the shareholder is entitled on a single director, which increases the shareholder's voting power with respect to electing such director. As permitted under Cayman Islands law, however, our articles of association do not provide for cumulative voting. As a result, our stockholders are not afforded any less protections or rights on this issue than stockholders of a Delaware corporation.

Removal of directors

Under the Delaware General Corporation Law, a director of a corporation with a classified board may be removed only for cause with the approval of a majority of the outstanding shares entitled to vote, unless the certificate of incorporation provides otherwise. Under our articles of association, directors can be removed with cause or by the vote of holders of a majority of our shares, cast at a general meeting, or by unanimous written resolution of all stockholders.

Transactions with interested shareholders

The Delaware General Corporation Law contains a business combination statute applicable to Delaware public corporations whereby, unless the corporation has specifically elected not to be governed by such statute by amendment to its certificate of incorporation, it is prohibited from engaging in certain business combinations with an "interested shareholder" for three years following the date that such person becomes an interested shareholder. An interested shareholder generally is a person or group who or which owns or owned 15% or more of the target's outstanding voting stock within the past three years. This has the effect of limiting the ability of a potential acquirer to make a two-tiered bid for the target in which all shareholders would not be treated equally. The statute does not apply if, among other things, prior to the date on which such shareholder becomes an interested shareholder, the board of directors approves either the business combination or the transaction which resulted in the person becoming an interested shareholder. This encourages any potential acquirer of a Delaware public corporation to negotiate the terms of any acquisition transaction with the target's board of directors.

Cayman Islands law has no comparable statute. As a result, we cannot avail ourselves of the types of protections afforded by the Delaware business combination statute. However, although Cayman Islands law does not regulate transactions between a company and its significant shareholders, it does provide that such transactions must be entered into bona fide in the best interests of the company and not with the effect of constituting a fraud on the minority stockholders.

Dissolution; Winding up

Under the Delaware General Corporation Law, unless the board of directors approves the proposal to dissolve, dissolution must be approved by shareholders holding 100% of the total voting power of the corporation. Only if the dissolution is initiated by the board of directors may it be approved by a simple majority of the corporation's outstanding shares. Delaware law allows a Delaware corporation to include in its certificate of incorporation a supermajority voting requirement in connection with dissolutions initiated by the board. Under the Companies Law of the Cayman Islands and our articles of association, our company may be voluntarily dissolved, liquidated or wound up only by the vote of holders of two-thirds of our shares voting at a meeting or by the holders of at least one-half of our shares voting at a meeting if the Company is no longer able to pay its debts as they fall due or in each case by the unanimous written resolution of all shareholders. In addition, our company may be wound up by the Grand Court of the Cayman Islands if the company is unable to pay its debts or if the court is of the opinion that it is just and equitable that our company is wound up.

Variation of rights of shares

Under the Delaware General Corporation Law, a corporation may vary the rights of a class of shares with the approval of a majority of the outstanding shares of such class, unless the certificate of incorporation provides otherwise. Under Cayman Islands law and our articles of association, if our share capital is divided into more than one class of shares, we may vary the rights attached to any class only with the vote at a class meeting of holders of two-thirds of the shares of such class or unanimous written resolution, provided that if such variation has the effect of altering our articles of association, the variation will need to be approved in the manner described under the heading “Amendment of governing documents.”

Amendment of governing documents

Under the Delaware General Corporation Law, a corporation’s governing documents may be amended with the approval of a majority of the outstanding shares entitled to vote, unless the certificate of incorporation provides otherwise. As permitted by Cayman Islands law, our memorandum and articles of association may only be amended with the vote of holders of two-thirds of our shares voting at a meeting or the unanimous written resolution of all shareholders.

Indemnification of directors and executive officers and limitation of liability

Cayman Islands law does not limit the extent to which a company’s articles of association may provide for indemnification of officers and directors, except to the extent any such provision may be held by the Cayman Islands courts to be contrary to public policy, such as to provide indemnification against civil fraud or the consequences of committing a crime or gross negligence or willful default. Our memorandum and articles of association permit indemnification of officers and directors for losses, damages, costs and expenses incurred in their capacities as such unless such losses or damages arise from dishonesty, fraud, gross negligence or willful default of such directors or officers. This standard of conduct is generally the same as permitted under the Delaware General Corporation Law to a Delaware corporation.

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to our directors, officers or persons controlling us under the foregoing provisions, we have been informed that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act of 1933 and is therefore unenforceable as a matter of United States law.

Rights of non-resident or foreign shareholders

There are no limitations imposed by our memorandum and articles of association on the rights of non-resident or foreign shareholders to hold or exercise voting rights on our shares. In addition, there are no provisions in our memorandum and articles of association governing the ownership threshold above which shareholder ownership must be disclosed.

Inspection of books and records

Holders of our ordinary shares will have no general right under Cayman Islands law to inspect or obtain copies of our list of shareholders or corporate records except our memorandum and articles of association. However, we will provide our shareholders with annual audited consolidated financial statements.

Share Option Plans

In connection with our initial public offering, we established a pool for share options for the Domestic Companies' and our employees. This pool contains options to purchase up to 790,362 of our ordinary shares. The options will vest at a rate of 20% per year for five years and have an exercise price of the market price of our shares on the date the options are granted. To date, we issued 564,000 options out of our employee share option pool. We initially granted 293,000 options in 2009. We held a shareholder meeting in December 2010 and announced the resignation of three directors, and as a result of their resignation and that of an unrelated administrative employee, 100,000 options were forfeited and went back in the pool. In 2012, we granted an additional 415,000 options and 44,000 options were forfeited and went back to the pool. In the three months ended June 30, 2014, 148,400 vested options from 2012 grants were exercised. In 2015, the Company established a new incentive pool to issue options to purchase up to 700,000 shares of our ordinary shares. The Company granted options to purchase 400,000 ordinary shares to its employees and non-employee directors on January 31, 2015 under the 2015 option plan, the remaining 300,000 shares were granted as restricted ordinary shares to Messrs. Yin and Chen. As of June 30, 2015, we have 815,600 options outstanding.

On July 11, 2015, the Company’s board of directors reserved an additional 800,000 shares and options under the 2015 option plan, which were all granted as of October 15, 2015.

FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The full text of our audited consolidated financial statements as of June 30, 2015 and 2014 and the interim unaudited financial statements as of December 31, 2015 and 2014 are incorporated by reference to our Annual Report on Form 10-K for the fiscal year ended June 30, 2015, filed with the SEC on September 25, 2015 and our Quarterly Report on Form 10-Q for the six months ended December 31, 2015, filed with the SEC on February 16, 2016.

SELECTED FINANCIAL DATA

The Company is not required to provide the information required by this Item because the Company is a smaller reporting company.

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

For Management’s Discussion and Analysis of Financial Condition and Results of Operations for the fiscal years ended June 30, 2015 and 2014, please see Item 7 in our Annual Report on Form 10-K for the fiscal year ended June 30, 2015, filed with the SEC on September 25, 2015, which is incorporated herein by reference.

For Management’s Discussion and Analysis of Financial Condition and Results of Operations for the three and six months ended December 31, 2015 and 2014, please see Item 2 in our quarterly Report on Form 10-Q for the three and six months ended December 31, 2015 filed with the SEC on February 16, 2016, which is incorporated herein by reference.

CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not required for Smaller Reporting Companies.

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INFORMATION ABOUT QHHY

Overview

QHHY is an oilfield service company providing a wide range of downhole technology support and services primarily in Qinghai Province, China. QHHY has more than 130 employees and is a qualified oilfield service provider for PetroChina, among other companies. QHHY's solutions are aimed at keeping working wells safe while helping to increase oil well production. This cost effective approach may be particularly important to oil companies during times of depressed oil prices.

History

QHHY was incorporated in Mangya Huatugou, Qinghai Province, China on September 8, 2011 with a registered capital of RMB 5 million (approximately $0.8 million). On September 26, 2013, QHHY increased its registered capital to RMB 10 million (approximately $1.6 million).

Services and Market

QHHY provides services to domestic oilfield companies to help them increase oil well production and productivity. QHHY mainly provides workover services in Qinghai Province, one of the major oil producing regions in western China. The Company is qualified to provide workover services to China Natural Petroleum Corporation (“CNPC”), as well as to provide services that assist in increasing the production from oil wells, such as project services and fracturing services to China Petroleum & Chemical Corporation (“Sinopec”). The Company will continue to expand its market by making full use of its current qualification.

Strategy

QHHY’s strategy focuses on providing services to working wells, an area subject to less intense competition as compared to other segments in the oil industry. Working wells require ongoing resources and services to maintain production regardless of oil price. Currently, companies in China are opening non-core business segments to private markets. To be a leading company in this segment, companies must earn a stable profit and maintain good business relationships with oilfield companies. QHHY aims to compete by maintaining enough working rigs, a professional management team and enough skilled workers to fulfill all jobs for which QHHY is hired.

Marketing and Sales

Due to its strong relationships with oil companies, QHHY has historically incurred little marketing expense. As the service demand of its customer base remains stable and the oilfield service has opened to private companies, QHHY’s management believes the company’s sales will increase steadily going forward.

In addition, with increased capital investment, QHHY plans to replace some of its current equipment so that it can provide more complicated services with higher margins to its existing clients and expand its potential market.

Customers

QHHY provides services to CNPC under a series of downhole operating service agreements. Specifically, QHHY has entered into such agreements with two oil plants owned by CNPC in its Qinghai oilfield. CNPC accounted for approximately 80% and 99% of QHHY’s revenues for the fiscal years ended June 30, 2015 and 2014, respectively, and any termination of its business relationship with CNPC would materially harm QHHY’s operations.

Competition

Just as in other segments of the oilfield service industry, a majority of the market has historically been protected and was only open to state-owned companies. Private companies were thus competing for the remaining segment of the market. Thus, QHHY’s competitors consist of both private and state-owned entities.

QHHY’S competitors include:

- Xi'an Chang Kan Oil & Gas Technology Development Co. Ltd. Xi’an is a private oilfield service company that provides downhole services, drilling services and crude oil transportation services.

- Karamay Hongxing Co. Ltd. Karamay is a private company whose business includes providing downhole services and workover services. Karamay was formerly a subsidiary of the Xinjiang Oilfield Bureau.

- Mangya Zhongyuan Oil Technology Service Co. Ltd. Mangya, a subsidiary of Sinopec Zhongyuan Oilfield, is a large company that provides a wide range of oilfiled services, including drilling, workover, well cementation and oil well testing, among other things.

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QHHY believes that the following competitive strengths will allow it to continue to grow and effectively compete with other companies in this industry.

- Experienced management in the workover segment;
- Advanced equipment and continuous investment in upgrading equipment; and
- High efficiency as compared to state owned enterprises.

Research and Development

QHHY historically did not incur any research and development expenses. However, it plans to devote more resources into research and development in the near future.

Intellectual Property

QHHY does not presently own any intellectual property.

Government Regulation

Regulations on Foreign Exchange

Foreign Currency Exchange. Under the PRC foreign exchange regulations, payments of current account items, such as profit distributions and trade and service-related foreign exchange transactions, may be made in foreign currencies without prior approval from SAFE by complying with certain procedural requirements. By contrast, approval from or registration with appropriate government authorities is required where RMB is to be converted into foreign currency and remitted out of China to pay capital expenses such as the repayment of foreign currency-denominated loans or foreign currency is to be remitted into China under the capital account, such as a capital increase or foreign currency loans to our PRC subsidiaries.

SAFE issued the Circular on the Relevant Operating Issues Concerning the Improvement of the Administration of the Payment and Settlement of Foreign Currency Capital of Foreign-Invested Enterprises (2008), or SAFE Circular 142, regulating the conversion by a foreign-invested enterprise of foreign currency-registered capital into RMB by restricting how the converted RMB may be used. In addition, SAFE promulgated Circular 45 on November 9, 2011 in order to clarify the application of SAFE Circular 142. Under SAFE Circular 142 and Circular 45, the RMB capital converted from foreign currency registered capital of a foreign-invested enterprise may only be used for purposes within the business scope approved by the applicable government authority and may not be used for equity investments within the PRC. In addition, SAFE strengthened its oversight of the flow and use of the RMB capital converted from foreign currency registered capital of foreign-invested enterprises. The use of such RMB capital may not be changed without SAFE’s approval, and such RMB capital may not in any case be used to repay RMB loans if the proceeds of such loans have not been used.

Since SAFE Circular 142 has been in place for more than five years, SAFE decided to further reform the foreign exchange administration system in order to satisfy and facilitate the business and capital operations of foreign invested enterprises, and issued the Circular on the Relevant Issues Concerning the Launch of Reforming Trial of the Administration Model of the Settlement of Foreign Currency Capital of Foreign-Invested Enterprises in Certain Areas on August 4, 2014. This circular suspends the application of SAFE Circular 142 in certain areas and allows a foreign-invested enterprise registered in such areas with a business scope including “investment” to use the RMB capital converted from foreign currency registered capital for equity investments within the PRC.

SAFE promulgated Circular 59 in November 2010, which tightens the regulation over settlement of net proceeds from overseas offerings, such as our initial public offering, and requires, among other things, the authenticity of settlement of net proceeds from offshore offerings to be closely examined and the net proceeds to be settled in the manner described in the offering documents or otherwise approved by our board. Violations of these SAFE regulations may result in severe monetary or other penalties, including confiscation of earnings derived from such violation activities, a fine of up to 30% of the RMB funds converted from the foreign invested funds or in the case of a severe violation, a fine ranging from 30% to 100% of the RMB funds converted from the foreign-invested funds.

In November 2012, SAFE promulgated the Circular of Further Improving and Adjusting Foreign Exchange Administration Policies on Foreign Direct Investment, which substantially amends and simplifies the current foreign exchange procedure. Pursuant to this circular, the opening of various special purpose foreign exchange accounts, such as pre-establishment expenses accounts, foreign exchange capital accounts and guarantee accounts, the reinvestment of RMB proceeds by foreign investors in the PRC, and remittance of foreign exchange profits and dividends by a foreign-invested enterprise to its foreign shareholders no longer require the approval or verification of SAFE, and multiple capital accounts for the same entity may be opened in different provinces, which was not possible previously. In addition, SAFE promulgated the Circular on Printing and Distributing the Provisions on Foreign Exchange Administration over Domestic Direct Investment by Foreign Investors and the Supporting Documents in May 2013, which specifies that the administration by SAFE or its local branches over direct investment by foreign investors in the PRC shall be conducted by way of registration and banks shall process foreign exchange business relating to the direct investment in the PRC based on the registration information provided by SAFE and its branches.

Regulation of Dividend Distribution. The principal regulations governing the distribution of dividends by foreign holding companies include the Foreign Investment Enterprise Law (1986), as amended, and the Administrative Rules under the Foreign Investment Enterprise Law (2001).

Under these regulations, foreign investment enterprises in China may pay dividends only out of their retained profits, if any, determined in accordance with PRC accounting standards and regulations. In addition, foreign investment enterprises in China are required to allocate at least 10% of their respective retained profits each year, if any, to fund certain reserve funds unless these reserves have reached 50% of the registered capital of the enterprises. These reserves are not distributable as cash dividends.

SAFE Circular 37, on July 4, 2014, which replaced the former circular commonly known as “SAFE Circular 75” promulgated by SAFE on October 21, 2005. SAFE Circular 37 requires PRC residents to register with local branches of SAFE in connection with their direct establishment or indirect control of an offshore entity, for the purpose of overseas investment and financing, with such PRC residents’ legally owned assets or equity interests in domestic enterprises or offshore assets or interests, referred to in SAFE Circular 37 as a “special purpose vehicle.” SAFE Circular 37 further requires amendment to the registration in the event of any significant changes with respect to the special purpose vehicle, such as increase or decrease of capital contributed by PRC individuals, share transfer or exchange, merger, division or other material event. In the event that a PRC shareholder holding interests in a special purpose vehicle fails to fulfill the required SAFE registration, the PRC subsidiaries of that special purpose vehicle may be prohibited from making profit distributions to the offshore parent and from carrying out subsequent cross-border foreign exchange activities, and the special purpose vehicle may be restricted in its ability to contribute additional capital into its PRC subsidiary. Furthermore, failure to comply with the various SAFE registration requirements described above could result in liability under PRC law for evasion of foreign exchange controls.

Regulations on Foreign Investment in the Automation Service Industry and Oil Exploration and Extraction Industry in the PRC. In accordance with the Catalogue of Industries for Guiding Foreign Investment (Revised 2007), the oil and gas automation service industries are in the catalogue of permitted industries, and thus there are no restrictions on foreign investment in China's oil and gas automation industry. In addition, the following industries are encouraged for foreign investment in China:

- manufacturing of equipment for oil exploration, drilling, collection and transportation: floating drilling systems and floating production systems with an operating water depth of more than 1,500 meters and the supporting subsea oil extraction, collection and transportation equipment
- exploration and exploitation of oil and natural gas with venture capital (limited to equity joint ventures and cooperative joint ventures);
- development and application of new technologies that increase the recovery ratio of crude oil (limited to equity joint ventures and cooperative joint ventures);
- development and application of new oil exploration and exploitation technologies such as geophysical exploration, drilling, well logging, and downhole operation, etc. (limited to cooperative joint ventures); and
- exploration and development of unconventional oil resources such as oil shale, oil sands, heavy oil, and excess oil (limited to cooperative joint ventures).

Environmental Matters

QHHY has not incurred any material expense in connection with compliance with Chinese environmental laws and regulations. We do not anticipate expending any material amounts for such compliance purposes for the remainder of our current or succeeding fiscal year.

Regulations Relating to Labor. QHHY is subject to laws and regulations governing its relationship with its employees, including wage and hour requirements, working and safety conditions, and social insurance, housing funds and other welfare. The compliance with these laws and regulations may require substantial resources.

Pursuant to the PRC Labor Law, which became effective in 1995, and the PRC Labor Contract Law, which became effective in 2008 and was amended in 2012, a written labor contract is required when an employment relationship is established between an employer and an employee. Other labor-related rules and regulations in China stipulate the maximum number of hours employees can work each day and week, as well as setting minimum wages. An employer is required to set up occupational safety and sanitation systems, implement the national occupational safety and sanitation rules and standards, educate employees on occupational safety and sanitation, and prevent accidents at work and reduce occupational hazards.

An employer is obligated to sign an indefinite term labor contract with an employee if the employer continues to employ the employee after two consecutive fixed-term labor contracts, with certain exceptions. The employer also has to pay compensation to the employee if the employer terminates an indefinite term labor contract, with certain exceptions. Except where the employer proposes to renew a labor contract by maintaining or raising the conditions of the labor contract and the employee is not agreeable to the renewal, an employer is required to compensate the employee when a definite term labor contract expires. Furthermore, under the Regulations on Paid Annual Leave for Employees issued by the State Council in December 2007 and effective as of January 2008, an employee who has served an employer for more than one year and less than ten years is entitled to a 5-day paid vacation, those whose service period ranges from 10 to 20 years are entitled to a 10-day paid vacation, and those who have served for more than 20 years are entitled to a 15-day paid vacation. An employee who does not use such vacation time at the request of the employer must be compensated at three times their normal salaries for each waived vacation day.

Pursuant to the Regulations on Occupational Injury Insurance effective in 2004, as amended in 2010, and the Interim Measures concerning the Maternity Insurance for Enterprise Employees, effective in 1995, PRC companies must pay occupational injury insurance premiums and maternity insurance premiums for their employees. Pursuant to the Interim Regulations on the Collection and Payment of Social Insurance Premiums effective in 1999 and the Interim Measures concerning the Administration of the Registration of Social Insurance effective in 1999, basic pension insurance, medical insurance and unemployment insurance are collectively referred to as social insurance. Both PRC companies and their employees are required to contribute to social insurance plans. The aforesaid measures are reiterated in the Social Insurance Law of China, effective in July 2011, which stipulates the system of social insurance of China, including basic pension insurance, medical insurance, unemployment insurance, occupational injury insurance and maternity insurance. Pursuant to the Regulations on the Administration of Housing Fund, effective in 1999 and as amended in 2002, PRC companies must register with applicable housing fund management centers and establish a special housing fund account in an entrusted bank. Both PRC companies and their employees are required to contribute to the housing fund.

Employees

As of April 25, 2016, QHHY had 127 employees. None of QHHY's employees are represented by a labor union and QHHY believes its employee relations are good.

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Facilities

QHHY currently owns seven workover rigs used for its operations. QHHY maintains its headquarters at No. 0467, Huang Chen Road, Hua Tu Gou, Mang Ya City, Qinghai Province, PRC.

Insurance

QHHY maintains an insurance policy with respect to injuries and health–related claims for certain of its employees.

Legal Proceedings

From time to time QHHY may become involved in other legal proceedings and claims, or be threatened with other legal actions and claims, arising in the ordinary course of business. QHHY is not presently involved in any legal proceedings.

Market Price of and Dividends on QHHY' Securities and Related Stockholder Matters

Historical market price information regarding QHHY's securities is not provided as QHHY is a private entity with no public market for its securities.

As of April 25, 2016, there were three holders of QHHY's equity interest.

Dividends

None.

Equity Compensation Plan Information

QHHY does not have an equity compensation plan.

Certain Relationships and Related Party Transactions

QHHY has had no related party transactions for fiscal year 2014 and 2015.

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of QHHY's financial condition and results of operations should be read in conjunction with the consolidated financial statements and the related notes included elsewhere in this proxy. This discussion contains forward-looking statements that involve risks and uncertainties. Actual results and the timing of selected events could differ materially from those anticipated in these forward-looking statements as a result of various factors.

Historical market price information regarding QHHY's securities is not provided because there is no public market for QHHY's securities.

Results of Operations

For The Fiscal Years Ended June 30, 2014 And 2015

The following of operations include the results of operations of QHHY for the fiscal years ended June 30, 2014 and 2015.

Revenue and Cost

	For the Years Ended June 30,			
	2014	2015	Increase / (Decrease)	Percentage Change
Revenue	¥11,063,965	¥12,195,278	¥1,131,313	10.2 %
Cost of revenue	7,213,902	8,838,960	1,625,058	22.5 %
Gross profit	¥3,850,063	¥3,356,318	¥(493,745)	(12.8)%
Margin %	34.8 %	27.5 %	(7.3)%	-

Revenue. Total revenues for the year ended June 30, 2015 were approximately ¥12.2 million ($1.9 million), an increase of approximately ¥1.1 million ($0.2 million) or 10.2% from ¥11.1 million for the year ended June 30, 2014. This was mainly caused by revenue from services rendered to a new client.

Cost of Revenues. Cost of revenues mainly includes raw materials, fuel and labor costs. Cost of revenues increased from approximately ¥7.2 million in the year ended June 30, 2014 to approximately ¥8.8 million ($1.4 million) for the same period of 2015, an increase of approximately ¥1.6 million ($0.3 million), or 22.5%. As a percentage of revenues, cost of revenues increased from 65.2% in 2014 to 72.5% in 2015. This increase was mainly caused by the increased cost of raw materials related to services rendered.

Gross Profit. Gross profit decreased slightly to ¥3.4 million ($0.5 million) for the year ended June 30, 2015 from approximately ¥3.8 million for the year ended June 30, 2014. This was mainly due to increased materials cost during the year ended June 30, 2015 as compared to the same period last year. Gross profit as a percentage of revenue decreased to 27.5 % for the year ended June 30, 2015 compared to 34.8% for the same period in 2014.

Operating Expenses

	For the Years Ended June 30,			
	2014	2015	Increase / (Decrease)	Percentage Change
General and administrative expenses	2,329,259	1,807,072	(522,187)	(22.4)%
% of revenue	21.1 %	14.8 %	(6.3)%	—
Operating expenses	¥2,329,259	¥1,807,072	¥(522,187)	(22.4)%

General and Administrative Expenses. General and administrative expenses consist primarily of costs in human resources, facilities costs, entertainment expense and other expenses incurred in connection with general operations. General and administrative expenses decreased by 22.4%, or ¥0.5 million ($0.1 million), from approximately ¥2.3 million in the year ended June 30, 2014 to approximately ¥1.8 million ($0.3 million) in the same period of 2015. General and administrative expenses were 21.1% of total revenues in 2014 and 14.8% of total revenues in 2015. The decrease in general and administrative expenses was mainly due to a bad debt allowance occurred in 2014 while there was no such expense in 2015.

Net Income

	For the Years Ended June 30,				
	2014	2015	Increase / (Decrease)	Percentage Change	
Income from operations	¥1,520,804	¥1,549,246	¥28,442	1.9	%
Interest and other income(expense)	(341,019)	380	341,399	100.1	%
Income before income taxes	1,179,785	1,549,626	369,841	31.4	%
Provision for income taxes	382,414	439,196	56,782	14.8	%
Net income	¥797,371	¥1,110,430	¥313,059	39.3	%

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Income from Operations. Income from operations was approximately ¥1.54 million ($0.2 million) for the year ended June 30, 2015, compared to income of ¥1.52 million for the same period in 2014.

Interest and Other Income (Expense). Interest and other income was approximately ¥380 ($60) for the year ended June 30, 2015, compared to interest and other expense of ¥341,019 for the same period of 2014. The ¥0.3 million ($0.05 million) decrease in interest and other income was primarily due to an uncollectible non-operating expense in 2014 while there is no such loss for 2015.

Provision for Income Tax. Provision for income tax for the year ended June 30, 2014 was approximately ¥382,414 and ¥439,196 ($0.07 million) for the year ended June 30, 2015. This increase of benefit for income tax was mainly due to increase of taxable income.

Net Income. As a result of the factors described above, net income was approximately ¥1.1 million ($0.2 million) for the year ended June 30, 2015, an increase of approximately ¥0.3 million ($0.05 million) from net income of ¥0.8 million for the same period of 2014.

For The Six Months Ended December 31, 2014 And 2015

The following of operations include the results of operations of QHHY for the six months ended December 31, 2014 and 2015.

Revenue and Cost

	For the Six Months Ended December 31,		**Increase /**	**Percentage**
	2014	2015	**(Decrease)**	**Change**
Revenue	¥ 7,857,293	¥ 7,483,264	(374,029)	(4.76)%
Cost of revenue	5,640,468	5,562,076	(78,392)	(1.39)%
Gross profit	¥ 2,216,825	¥ 1,921,188	(295,637)	(13.34)%
Margin %	28.21 %	25.67 %	(2.54)%	-

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Revenue. Total revenues for the six months ended December 31, 2015 were approximately ¥7.5 million ($1.2 million), a decrease of approximately ¥0.4 million ($0.06 million) or 4.8% from ¥7.9 million for the six months ended December 31, 2014. For the six months ended December 31, 2014, we have completed 73 work orders. For the same period of 2015, we completed 108 work orders. The increase in work orders with a decrease in revenue was caused by QHHY's customers' less complicated work orders, which resulted in fewer services being provided for the six months ended December 31, 2015 as compared to the same period in 2014.

Cost of Revenues. Cost of revenues mainly consists of raw materials, fuels and labor costs. Cost of revenues maintained steadily around ¥5.6 million for the six months ended December 31, 2014 and 2015. As a percentage of revenues, cost of revenues increased from 71.8% in 2014 to 74.3% in 2015. This increase was mainly caused by the Company having lower revenues for the same period of 2015 as compared to 2014, while fixed costs remained at the same level for both periods with a slight increase in material costs during the six months ended December 31, 2015 as compared to the same period in 2014.

Gross Profit. Gross profit decreased to ¥1.9 million ($0.3 million) for the six months ended December 31, 2015 from approximately ¥2.2 million for the six months ended December 31, 2014. This was mainly due to lower revenue recognized during the six month period ended December 31, 2015 as compared to the same period last year. Gross profit as a percentage of revenue decreased to 25.7% for the six months ended December 31, 2015 compared to 28.2% for the same period in 2014.

Operating Expense

	For the Six Months Ended December 31,			
	2014	**2015**	**Increase/(Decrease)**	Percentage Change
General and administrative expenses	¥ 874,379	¥ 977,910	¥ 103,531	11.8 %
% of revenue	11.1 %	13.1 %	2.0 %	—
Operating expenses	¥ 874,379	¥ 977,910	¥ 103,531	11.8 %

General and Administrative Expenses. General and administrative expenses consist primarily of costs in human resources, facilities costs, entertainment expense and other expenses incurred in connection with general operations. General and administrative expenses increased by 11.8%, or ¥0.1 million, from approximately ¥0.9 million for the six months ended December 31, 2014 to approximately ¥1.0 million ($0.2million) in the same period of 2015. General and administrative expenses were 11.1% of total revenues in 2014 and 13.1% of total revenues in 2015. The increase in general and administrative expenses was mainly due to increased financial consulting fees and employee welfare spending.

Net Income

	For the Six Months Ended December 31,			
	2014	**2015**	**Increase/(Decrease)**	Percentage Change
Income from operations	¥1,342,446	¥943,278	¥ (399,168)	(29.7)%
Interest and other income(expense)	1,268	(131,067)	(132,335)	(10,436.5)%
Income before income taxes	1,343,714	812,211	(531,503)	(39.6)%
Provision for income taxes	335,932	203,053	(132,879)	(39.6)%
Net income	¥1,007,782	¥609,158	¥ (398,624)	(39.6)%

Income from Operations. Income from operations was approximately ¥0.9 million ($0.1 million) for the six months ended December 31, 2015, compared to income of ¥1.3 million for the same period of 2014.

Interest and Other Income (Expense). Interest and other expense was ¥131,067 ($20,193) for the six months ended December 31, 2015, compared to interest and other income of ¥1,268 for the same period of 2014. The increase in interest was primarily due to increased bank loan interest.

Provision for Income Tax. Provision for income tax for the six months ended December 31, 2014 was ¥335,932 and ¥203,053 ($0.03 million) for the six months ended December 31, 2015. This decrease of benefit for income tax was mainly due to less taxable income.

Net Income. As a result of the factors described above, net income was approximately ¥0.6 million ($0.1 million) for the six months ended December 31, 2015, a decrease of approximately ¥0.4 million ($0.1 million) from net income of ¥1.0 million for the same period of 2014.

Liquidity and Capital Resources

Cash and Cash Equivalents. Cash and cash equivalents are comprised of cash on hand, demand deposits and highly liquid short-term debt investments with stated maturities of no more than six months. As of December 31, 2015, QHHY had cash and cash equivalents in the amount of ¥395,609 ($0.06 million). As of June 30, 2015, QHHY had cash and cash equivalents in the amount of approximately ¥229,000.

Indebtedness. As of December 31, 2015, except for approximately ¥3.5 million ($0.5 million) related to a commercial bank loan, QHHY did not have any finance leases or purchase commitments, guarantees or other material contingent liabilities.

Off-Balance Sheet Arrangements. QHHY has not entered into any financial guarantees or other commitments to guarantee the payment obligations of any third parties. In addition, QHHY has not entered into any derivative contracts that are indexed to its own shares and classified as shareholders' equity, or that are not reflected in its financial statements. Furthermore, QHHY does not have any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity. Moreover, QHHY does not have any variable interest in an unconsolidated entity that provides financing, liquidity, market risk or credit support to us or engages in leasing, hedging or research and development services with it.

Capital Resources. To date, QHHY has financed its operations primarily through cash flows from operations and bank loans, which were mainly used for special equipment update. As of December 31, 2015, QHHY had total assets of approximately ¥19.5 million ($3.0 million), which includes cash of approximately ¥0.4 million ($0.06 million), net accounts receivable due from third parties of approximately ¥8.2 million ($1.3 million), working capital amounted to approximately ¥3.0million ($0.5 million), and shareholders’ equity amounted to approximately ¥10.4 million ($1.6 million).

Cash from Operating Activities. Net cash used in operating activities was approximately ¥0.7 million ($0.1 million) for the six months ended December 31, 2015. This was a decrease of approximately ¥3.1 million ($0.5 million) compared to net cash provided by operating activities of approximately ¥2.4 million for the six months ended December 31, 2014. This decrease was mainly caused by an increase in trade accounts receivable and notes receivable from QHHY’s clients.

Cash from Investing Activities. Net cash used in investing activities amounted to ¥2.6 million ($0.4 million) for the six months ended December 31, 2015, as compared to cash flows used in investing activities of $0.04 million for the same period in 2014. Funds used in investing activities were for purchase of special rigs used for operations.

Cash from Financing Activities. Net cash provided by financing activities amounted to ¥3.5 million ($0.5 million) for the six months ended December 31, 2015, as compared to $0 for the same period in 2014.This was the first time QHHY obtained a bank loan from a commercial bank owned by CNPC.

Selected Financial Data (including Pro Forma)

Please refer to Annex B, Financial statements and notes to QHHY.

Supplementary Financial Information (including Pro Forma)

Not applicable to smaller reporting companies.

Financial Statements (including Pro Forma)

Please refer to Annex B, Financial statements and notes to QHHY.

Quantitative and Qualitative Disclosures about Market Risk

Not applicable.

Vote Required; Recommendation of the Board of Directors

If a quorum is present, the approval and adoption of the Share Purchase Agreement requires the affirmative vote of a majority of the shares present in person or represented by proxy at a duly called meeting.

The board of directors recommends a vote "FOR" the proposal to approve the Share Purchase Agreement and the Transactions contemplated thereby.

PROPOSAL 4

APPROVAL OF THE ISSUANCE OF ORDINARY SHARES

PURSUANT TO THE SHARE PURCHASE AGREEMENT

The board of directors has determined that the issuance of ordinary shares to the QHHY Shareholders pursuant to the Share Purchase Agreement is advisable and in the best interests of the Company and its stockholders and has approved the issuance of 2,686,567 ordinary shares to the QHHY Shareholders pursuant to the Share Purchase Agreement.

If a quorum is present, the approval of the issuance of the ordinary shares pursuant to the Share Purchase Agreement requires the affirmative vote of a majority of the ordinary shares present in person or represented by proxy at a duly called meeting.

In voting in favor of the Share Purchase Agreement and the Transactions contemplated thereby, the board of directors is recommending that its stockholders authorize the issuance of 2,686,567 ordinary shares to the QHHY Shareholders. In addition, our ordinary shares are currently listed on The NASDAQ Capital Market and therefore we are subject to the NASDAQ Listing Rules. Pursuant to NASDAQ Stock Market Listing Rule 5635(d)(2), if an issuer intends to issue securities in a transaction that could result in the issuance of more than 20% of the issued and outstanding shares of the issuer's common stock on a pre-transaction basis for less than the greater of book or market value for such stock, the issuer generally must obtain the prior approval of its stockholders prior to such issuance.

The issuance of the ordinary shares pursuant to the Share Purchase Agreement will have a significant dilutive effect on our existing shareholders. Assuming stockholder approval, following the closing of the Share Purchase

Agreement, we will have 8,490,572 ordinary shares of outstanding. Upon the closing of the Share Purchase Agreement, the existing stockholders of the Company will hold approximately 68.36% of the issued and outstanding ordinary shares of the Company and the QHHY Shareholders will hold approximately 31.64% of the outstanding ordinary shares of the Company.

Relationship to the Share Purchase Agreement

Approval of this proposal is one of the conditions to the closing of the Share Purchase Agreement and the Transactions contemplated thereunder. **If this Proposal 4 is not approved by the stockholders, the Company will be unable to complete the Transactions.**

Vote Required; Recommendation of the Board of Directors

If a quorum is present, the approval of the issuance of the ordinary shares requires the affirmative vote of a majority of the shares present in person or represented by proxy at a duly called meeting.

The board of directors recommends a vote "FOR" the proposal to approve the issuance of the ordinary shares of the Company pursuant to the Share Purchase Agreement.

PROPOSAL 5

APPROVAL TO ADJOURN THE ANNUAL MEETING

The board of directors has determined that the adjournment of the Annual Meeting for any purpose, including to solicit additional proxies if there are insufficient votes at the time of the annual meeting to approve the proposals described herein, is advisable and in the best interests of the Company and its stockholders and has approved the adjournment of the Annual Meeting for any purpose, including to solicit additional proxies if there are insufficient votes at the time of the Annual Meeting to approve the proposals described herein.

Vote Required; Recommendation of the Board of Directors

The Annual Meeting may be adjourned by the affirmative vote of a majority of the shares present in person or represented by proxy at a duly called meeting.

The board of directors recommends a vote "FOR" the proposal to approve the adjournment of the Annual Meeting for any purpose, including to solicit additional proxies if there are insufficient votes at the time of the meeting to approve the proposals.

Annex A

Share Purchase Agreement

Share Purchase Agreement

_ 2015 12 1

This Agreement is executed in Beijing, China on this day of December 1, 2015 by and among:

Party A Recon Technology Ltd. 控科技有限公司）

授权代表 Authorized representative 银燊平 Shenping Yin

乙 Party B

乙 一 李素珍 Suzhen Li

乙 二 黄宝坤 Baokun Huang

乙 三 石 婧 Jing Shi

丙 Party
C 青海华油井 石油技术有限公&

Qinghai Hua You Downhole Technology Co., Ltd

授权代表 Authorized representative 黄宝坤 Baokun Huang

丁 Party
D 控恒达科技 ）有限公司

Recon Hengda Technology (Beijing) Co., Ltd.

授权代表Authorized representative 陈广强 Guangqiang Chen

鉴

In view of:

1.丙 是一家依照中华人民共和&
Party C is a limited liability company incorporated and currently in good standing under the laws

1

and regulations of the People’s Republic of China (PRC) with the registered address in Haixi Mongol and Tibetan Autonomous Prefecture of Qinghai province and a current registered capital of RMB 10 million yuan;

2. 乙 为丙 的现有登记 东，合&#35745
Party B represents the currently registered shareholders of Party C, holding collectively 100% of Party C’s outstanding capital stock;

3. 拟向乙 发行 ；
Party A intends to issue shares to Party B;

4. 丁 为 中国境内的子公司。
Party D is a subsidiary of Party A in the PRC.

上述合同 根据中华人民共和&#

According to the laws and regulations of the PRC and based on the principals of equality and voluntariness, after friendly negotiation, all Parties agree to the terms set forth below.

2

第一条 释义
Article 1 Definitions

1.1 除非 文意另有所指， 列词&#358
Unless otherwise indicated in this agreement, the terms below have the definitions as follows:

过渡期 Transition Period	指	署之 至就 项 第; The period between the execution date of this agreement and the completio
送达 Delivery	指	任一 按照 约定&# Delivery of documents by any Party pursuant to the delivery method set fo
This Agreement	指	《 》及附件。 The Share Purchase Agreement and Attachments.
工作 Working Days	指	中华人民共和国&# Days other than legal holidays set forth in the regulations promulgated by t
“/” “/”	指	“和/或” And/or
“超过”或“小 ” “more” or “less”	指	均不含 数 Does not include the number itself

1.2 的条款标题仅为了 便阅读&#652
The title of the provisions of this agreement are for reference only and shall not affect the meaning of the provisions herein.

第二条 发行前提
3

Article 2 Prerequisites of Stock Issuance

2.1 确认， 项 的发行 的义务 &#
All Parties shall confirm that the obligations of Party A to issue shares under this Agreement shall be under the following conditions, and Party B and Party C have the obligation to provide related evidence that all of the following conditions have been met:

乙 及丙 已经 书面形式向 充&#
2.1.1 Party B and Party C have made to Party A a full and complete disclosure of Party C's assets, liabilities, equities, guarante

过渡期内，丙 的经营或财&#2115
2.1.2 During the Transition Period, there is no material adverse change to the business or financial condition of Party C; Party C

过渡期内，未经 同意，乙 &#19
2.1.3 During the Transition Period, without Party A's consent, Party B shall not transfer all or any of Party C's shares held by P

4

过渡期内，乙 及丙 应 所有&#37
2.1.4 During the Transition Period, Party B and Party C shall preserve intact, in all material respects, Party C's business organiz

过渡期内，丙 作为连续经&#33829
2.1.5 During the Transition Period, as a continuous operating entity, Party C shall maintain its existence in good standing and it

过渡期内，无 书面同意 此&#31
2.1.6 Without limiting the generality of the foregoing sections, and except as contemplated by the terms of this Agreement, duri

修改、取消或变更公司注&#2087
2.1.6.1 Amend, waive or otherwise change, in any respect, its certificate of incorporation, bylaws or other similar organizationa

5

授权发行、发售、授予、&#2098

2.1.6.2 authorize for issuance, issue, grant, sell, pledge, dispose of or propose to issue, grant, sell, pledge or dispose of any of its

拆分，合并，重新资 化或&#373

2.1.6.3 split, combine, recapitalize or reclassify any of its equity interests or issue any other securities in respect thereof or pay

引致，创造，承担，支付&#2511

2.1.6.4 incur, create, assume, prepay or otherwise become liable for any indebtedness (directly, contingently or otherwise) in ex

6

法律要求范围或现有任何&#240

2.1.6.5 increase the wages, salaries or compensation of any of its employees by more than five percent (5%), or increase bonuse

作出或撤销任何关 税务的&#373

2.1.6.6 make or rescind any material election relating to taxes, settle any claim, action, suit, litigation, proceeding, arbitration, i

转移或授予任何第三 ，或&#251

2.1.6.7 transfer or license to any third party or otherwise extend, materially amend or modify, permit to lapse or fail to preserve

7

取消或放弃或转让任何丙 &#215
2.1.6.8 terminate or waive or assign any material right under any of Party C’s material contracts or any lease or enter into any c

未合理维护与过去交易相&#2085
2.1.6.9 fail to maintain its books, accounts and records in all material respects in the ordinary course of business consistent with

设立任何子公司或者设置&#260
2.1.6.10 establish any Subsidiary or enter into any new line of business;

未能通过商业上合理的努&#211
2.1.6.11 fail to use commercially reasonable efforts to keep in force insurance policies or replacement or revised policies provid

对现有重大资产进行重新&#202
2.1.6.12 revalue any of its material assets or make any change in accounting methods, principles or practices, except in complia

除只作出金钱赔偿外的，&#373

2.1.6.13 waive, release, assign, settle or compromise any claim, action or proceeding (including any suit, action, claim, proceed
has been reserved in the Company Financials;

结束或显著减少公司行为&#251

2.1.6.14 close or materially reduce its activities, or effect any layoff or other personnel reduction or change, at any of its faciliti

并 ，包括任何兼并，吸收&#21

2.1.6.15 acquire, including by merger, consolidation, acquisition of stock or assets, or any other form of business combination,

作出超过5万美元的资 化支&#2

2.1.6.16 make capital expenditures in excess of $50,000 (individually or in the aggregate);

9

采取全面或部分清算、解&#259
2.1.6.17 adopt a plan of complete or partial liquidation, dissolution, merger, consolidation, restructuring, recapitalization or oth

自愿承担重大合同中条款&#251
2.1.6.18 voluntarily incur any Liability or obligation (whether absolute, accrued, contingent or otherwise) in excess of $50,000

出售，出租，许可，交货&#251
2.1.6.19 sell, lease, license, transfer, exchange or swap, mortgage or otherwise pledge or encumber (including securitizations), c

就丙 的投票权作出任何 ，&#
2.1.6.20 enter into any agreement, understanding or arrangement with respect to the voting of Party C’s securities;

从事任何可能被合理认为&#235
2.1.6.21 take any action that would reasonably be expected to delay or impair the obtaining of any consents or approvals of any

达成，修改，放弃或取消 &#26
2.1.6.22 enter into, amend, waive or terminate (other than terminations in accordance with their terms) any transaction with any

10

2.1.6.23 授权或同意从事任何上述&#304
authorize or agree to do any of the foregoing actions.

2.2 若乙 或丙 存 任何违反 第2.1条
If Party B or Party C conducts any violation of the agreed conditions under Section 2.1, Party A shall have the right to unila

第三条 发行 案
Article 3 Share Issuance Plan

3.1 同意， 拟向乙 支付共计600万&
All Parties agree that Party A intends to pay a total of US$6 million in a combination of shares and cash as consideration to Party B, Party B1, Party B2 and Party B3, which will be distributed in accordance with each party's respective percentage of ownership interest in Party C. The above share issuance/cash payments will be completed in two phases, including:

1） 第一期拟向乙 发行360万美&#2080
In the first phase ("Phase One"), Party A shall issue shares with an aggregate value of US$3,600,000 to Party B, the

2） 第二期拟向乙 支付240万美&#2080
且该金额的支付需要满足&#3

11

,
且该金额的支付需要满足第3.3&#
In the second phase (“Phase Two”), Party A intends to pay US$2.4 million to Party B in cash; However, Party A has the right to adjust the amount to be paid pursuant to the provisions of Section 3.3 of this agreement and such cash payment shall not be due and owing until the conditions set forth in Section 3.3 have been met.

同意， 生效且满足 约定的

3.2 All Parties agree that Party A shall issue the shares described in Section 3.1 above in accordance with the provisions of this

已经对丙 完成了相关尽职

1）Party A has completed due diligence on Party C, and Party A is satisfied with the results of such due diligence.

次 发行已经取得所有相&#20851

2）All relevant consents and approvals have been obtained in connection with the share issuance, including approval b

已经 署 内容和形式上均&#2019

3）All Parities have signed the control agreements as set forth in the Attachment A.

4） 丙 无重大不利变化。
Party C has no material adverse change.

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所有根据 发行的 均为限&#210

5）All Shares issued pursuant to this Agreement shall be restricted ordinary shares and such shares shall be subject to a

同意， 满足 约定的条件后 &

3.3 All Parties agree to proceed with the Phase Two payment, as described in Section 3.1 above, so long as the following condit

丙 无重大不利变化；

1） Party C has no material adverse change;

丙 达成 业绩承诺

2） Party C shall have reached the following performance goals:

如果丙 2016财 可 实现净利润增&#

(a) If Party C’s net profit for fiscal year 2016 shall increase by 15%, as compared with fiscal year 2015’s financial statements, F

(b) 如果丙 2016财 或2017财 的实际净&#2103

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则2016财 或2017财 将向乙 支付的&#2961
N%/15%)。
If Party C's audited FY2016 and FY2017's net profit growth rate exceed's 15% (N%), Party A shall pay Party B an earn-out part by using the formula of $1.4 million or $1.0 million *(N%/15%).

(c) 依据上述3.3条(2)(b) 款实际向乙 支付的金额不得&
Party A shall, based on the above Section 3.3(2)(b), pay an amount to Party B not exceeding 200% of $1.4 million or $1.0 m

(d) 依据上述3.3条 2）款应向乙 支&
The above amounts due under this section 3.3(2) shall not be due and owing until after Party A has received and analyzed, t

3.4 同意，如 第3.3条约定的业绩&
All parties agree that, according to the performance commitments set forth in section 3.3, if Party C has a decrease in its act

第四条 相关手续的办理
Article 4 Related Procedures

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4.1 同意， 附件一控制 项 的 &#26435
All Parties agree that Party C will be responsible for the share pledge registration in accordance with the terms of the Control Agreement set forth in Attachment A.

4.2 权质押登记手续如产生任何&
Party C shall bear all expenses in connection with share pledge registration.

第五条 丙 管理
Article 5 Corporate Governance of Party C

5.1 乙 同意并保证，附件一的控&
Party B agrees and guarantees that, after signing the control agreement in attachment A, all rights of Party B as shareholders of Party C shall be exercised by Party D.

5.2 丁 权利。丁 享有作为 东所&#2013
Rights of Party D. As a shareholder, Party D shall have the following rights: (1) to attend shareholder meetings of Party C and sign shareholder resolutions, (2) to exercise shareholder rights under laws and bylaws of Party C, including but not limited to shareholder voting rights, right to sell, transfer, pledge or dispose of all or part of its shares; and (3) to act as Party B's authorized representative and appoint the legal representative, chairman of board of directors, director, supervisor, general manager and other members of senior management of Party C.

第六条 竞业限制
Article 6 Non-Competition

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6.1乙   承诺丙   是乙   经营相关业&#2115
Party B represents and warrants that Party C is the only operating entity it has established in this line of of business and that Party B will not in any way compete with Party C's business, whether that be by establishing or investing in any entity with the same primary business as Party C.

6.2乙   /丙   同意采取有效措施确&#2044
Party B and Party C agree to take effective measures to ensure that senior executives of Party C do not set up or participate in any other operating entities or affiliated entities with operations that compete with Party C.

6.3乙   同意，乙   /丙   违反   第6.1条&#12289
Party B agree that, if Party B or Party C breaches Sections 6.1 and 6.2 of this Agreement and causes any damage to Party A's or Party D's interests in any way, Party B will be liable for all direct and indirect damages of Party A and Party D.

第七条知识产权的占有与使&#29
Article 7 Possession and use of intellectual property

7.1乙   /丙   单独并共同声明、承&#3583
B and Party C, individually and jointly and severally, represent, warrant and guarantee that, at and after the execution of this
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7.2 若与丙 生产经营相关的知识&
intellectual property rights related to Party C’s products and operations are not under its name, Party B and Party C shall ens

第八条 债权和债务
Article 8 Debts and Liabilities

8.1 乙 /丙 ，分别和共同确认并&#2521
Party B and Party C, individually and jointly and severally, represent and warrant that there are no undisclosed existing or potential debts and liabilities prior to the execution of this Agreement (including but not limited to contractual liability, tort liability, and fines by various government agencies) and there will be no debts or liabilities will be entered into during the transition period without the consent of Party A and Party D (such consent not be unreasonably withheld).

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8.2 乙 同意，对未 书面形式向 &#252
Party B agrees to be liable for any debts and liabilities that have not been disclosed to Party A in writing. If Party C incurs any debts and liabilities, Party B shall compensate Party C in the full amount within five working days after the payment has been made by Party C.

第九条 保证和承诺
Article 9 Representations and Warranties

及丁 ，分别和共同向乙 和&#199
9.1 Party A and Party D, individually and jointly and severally, make the following representations and warranties to Party B an

1） 及丁 是依法注册成立并&#19988
A and Party D are enterprises legally registered and currently in good standing with the ability to sign this agreemen

9.2 乙 及丙 ，分别和共同向 和&#199
Party B and Party C, individually and jointly and severally, represent and warrant to Party A and Party D as follows:

(1) 丙 是一家依照中华人民共和&
Party C is a limited liability company duly formed, validly existing and in good standing under the laws of the PRC.

(2) 拥有 并履行 义务的全部权&#2
Party B and Party C each have the right and authority to sign this agreement, and to exercise rights and perform obligations hereunder. They have the qualifications and ability required to

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sign this agreement under PRC laws. The execution and performance of this agreement will not conflict with Party C’s bylaws, binding documents, including any governing laws, regulations and rules, or any agreement signed by Party C.

(3) 的 或履行不违反 其为一 的&
The execution or performance of this agreement will not violate any material agreement signed by any Party.

(4) 已就与 次交易有关的所有信&
Party B and Party C have made a full, detailed, complete and timely disclosure of all information and materials related to this transaction, and will continue to do so through the Transition Period, without any material omission, misleading or false information. Party B and Party C also represent and warrant that all documents provided to Party A are true, valid and complete as of the date of this Agreement and will remain so through the Transition Period.

(5) 保证丙 全面履行 约定的义&#211
Party B and Party C will fully perform their obligations under this agreement and Party B bears joint and several liabilities for Party C’s actions.

(6) 已向且 过渡期内持续向 披&#3870
Party B and Party C have already disclosed to Party A, and will continue to disclose through the Transition Period, all legal enforcement and government investigation related matters such as arbitration, litigation, and judicial enforcement and have made, and will continue to make, full disclosure with regard to the potential impact of such matters on Party C or its performance of this agreement.

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(7) 丙 目前及未来的财务会计报&
The financial statements of Party C, now and in the future, fairly and accurately reflect the operating results, assets and liabilities of Party C without any false element or intentional and partial omission of key facts to mislead Party A.

(8) 保证丙 的关键管理人员和技&
Key personnel and technical staff of Party C have signed employment agreements and related non-disclosure and non-compete agreements (per Party A’s request) for a period of not less than five years from the execution of this agreement. Originals or copies of all such confidentiality agreements have been, or will be during the Transition Period, delivered to Party A and Party D.

(9) 保证 署后30 内办理完成附件&
Party B and C will cooperate in completing the share pledge registration according to the control agreements attached heret

(10) 中国法律法规允许的情况 &#6529
If permitted by PRC laws and regulations, Party B shall complete, or cooperate with Party A and Party D to complete, fore

第十条 通知及送达
Article 10 Notices and Deliveries

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10.1 有效期内，因法律、法规&#1
Within the term of this agreement, if any changes in laws, regulations, and policies cause any loss of the ability or qualification of any Party to perform its obligations under this agreement which affects the performance of this agreement, such Party shall have the obligation to notify the other Parties within a reasonable time period.

10.2 同意，与 有关的任何通知&#
All Parties agree that any notice related to this agreement shall be given in writing.

10.3 通知送达 列地点或 的实际&#324
Notice should be delivered to the following locations or the actual business location or domicile of all Parties:

地址
朝阳区拂林路9号景龙国际大

Address of Party A: Room 1902, Jing long Guo ji,No. 9 Fulin Road, Chaoyang District,Beijing, P.R.China

乙 一地址 青海省茫崖花土沟&#

Address of Party B1: No. 0467, Huang Chen Road, Hua Tu Gou, Mang Ya city, Qinghai Province;

乙 二地址 青海省茫崖花土沟&#

Address of Part B2: No. 0467, Huang Chen Road, Hua Tu Gou, Mang Ya city, Qinghai Province, P.R. China;

乙 三地址 青海省茫崖花土沟&#

Address of Party B3: No. 0467, Huang Chen Road, Hua Tu Gou, Mang Ya city, Qinghai Province, P.R. China;

丙 地址
青海省茫崖花土沟环城路0467号&

Address of Party C: Address of Part B1: No. 0467, Huang Chen Road, Hua Tu Gou, Mang Ya city, Qinghai Province, P.R. China;

丁
地址 海淀区知春路51号慎昌&#22

Address of Party D: Room 5771, 5th Floor, Shen Chang Building, Zhi Chun Road, Haidian District, Beijing, P.R. China.

第十一条 违约及其责任
Article 11 Breach of Contract

11.1 生效后， 应按照 的规定&#20840
After this agreement becomes effective, any breach of any obligations, warranties or any other provisions under this agreement by any party due to reasons other than force majeure constitute a breach.

11.2 一旦发生违约行为 包括违&#21453
Once a breach occurs (including a breach of representations and warranties), the breaching Party shall pay damages to the other non-breaching Parties. Paying damages shall not affect the non-breaching Parties' request that the breaching Party to continue to perform under this agreement.

第十二条合同的变更、解除
Article 12 Amendment and Termination

12.1 的任何修改、变更应经合&#215
Any amendment and change to this agreement shall be based on negations of all Parties and shall become effective only after all Parties have signed the agreements on such amendment or

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change.

12.2 列情况 解除 经 当事人 商&#
This agreement can be terminated under the following conditions: (1) all Parties consent to the termination of this agreement after negotiation; (2) if any Party fails to cure its breach within 30 days or if any Party has breached the agreement two or more times, regardless of whether or not it has cured such breach, then the non-breaching Parties can unilaterally terminate the agreement; or (3) this agreement cannot be performed due to force majeure.

12.3 有权提出解除合同的一 应&#24403
The Party with the right to terminate shall notify the other Parties in writing and such notice shall become effective when it is delivered to other Parties.

12.4 被解除后，不影响一 当事&#20
After this Agreement is terminated, the rights of any Parties to obtain liquidated damages and compensation for loss of rights under this agreement shall not be affected.

第十三条 争 解决
Article 13 Settlement of Disputes

13.1 的效力、解释及履行均适&#299
The validity, interpretation, and performance of this agreement shall be governed by and construed in accordance with the laws of the PRC.

13.2 合同 当事人因 发生的任何&#
All Parties of this Agreement shall resolve any dispute arising from this agreement through

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friendly negotiation. If negotiation fails, all Parties have the right to choose arbitration before the China International Economic and Trade Arbitration Commission in Beijing. Final arbitration awards according to arbitration rules of such commission shall be binding on all Parties.

第十四条 附则
Article 14 Miscellaneous

14.1 自 字、盖章后成立并生效&
This agreement shall become effective after all Parties sign or place their stamps on the agreement.

14.2 未尽事宜， 可另行 署补充
All Parties can sign supplemental agreements with regard to any matters unaddressed in this agreement. Such supplemental agreements will be considered part of this agreement and have the same validity as this agreement.

14.3 用中文书写，一式6 ， 持&#19968968
This agreement is in Chinese with six originals, one for each Party and with the same validity.

无正文，为 署页）

(Intentionally Left Blank and Signature Page follows)

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页为《 》 字页

This page is the signature page of the Share Purchase Agreement

Party A Recon Technology Ltd. 控科技有限公司）

/s/ Shenping Yin

姓名/Name 银燊平Shenping Yin

职务/Title CEO

乙 一 李素珍

Party B1: Suzhen Li

/s/ Suzhen Li

乙 二 石 婧

Party B2: Jing Shi

/s/ Jing Shi

乙 三 黄宝坤

Party B3: Baokun Huang

/s/ Baokun Huang

丙 /Party C

青海华油井 石油技术有限公&

Qinghai Hua You Downhole Technology Co., Ltd

/s/ Baokun Huang

姓名/Name 黄宝坤Baokun Huang

职务/Title 法人代表/授权 字人Legal/ Authorized Representative

丁 /Party D

控恒达科技 ）有限公司

Recon Hengda Technology (Beijing) Co., Ltd .

/s/ Chen Guangqiang

姓名/Name 陈广强Guangqiang Chen

职务/Title 法人代表/授权 字人Legal/Authorize
representative

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附件一   控制

Attachment A: Control Agreement

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EXCLUSIVE EQUITY INTEREST PURCHASE AGREEMENT

THIS EXCLUSIVE EQUITY INTEREST PURCHASE AGREEMENT the “**Agreement**”） is entered into by and between the following parties on December 1, 2015.

Party A: Recon HengdaTechnology (Beijing) Co.,Ltd., a limited liability company (wholly invested by Taiwan, Hong Kong or Macau investors) duly established and valid existing under the PRC laws. Registered Address: Room 5771, Floor 5, Shenchang Building, Courtyard 51, Zhichun Road, Haidian District, Beijing, China.

Party B: HUANG Baokun, SHI Jing, LI Suzhen.

HUANG Baokun ID Num.:

SHI Jing ID Num.:

LI Suzhen ID Num.:

Party C: Qinghai Hua You Downhole Technology Co., Ltd., a limited liability company duly established and valid existing under the PRC laws.

Registered Address: Courtyard 0467, Huancheng Road, Huatugou town, Mangya District, Qinghai, China.

WHEREAS,

1. Party B collectively holds 100% equity interest in Party C;

2. Party A and Party C have entered into a series of Agreements including the Exclusive Consulting and Service Agreement.

NOW THEREFORE, through mutual negotiations, the Parties hereto agree as follows:

1. Transfer of Equity Interest

1.1 Granting Right

Under PRC law, Party B hereby irrevocably grants Party A the exclusive right to purchase, or designate one or more persons (the "**Specified Person**") to purchase, a portion or whole of the Equity Interest of Party C held by Party B at the price set forth in Article 1.3 hereof in accordance with the procedure promulgated by Party A at any time in Party A's discretion. (the "**Purchase Right**"). Except for Party A and the Specified Person, Party C shall not sell the Equity Interest to any third party. Party C hereby agrees that Party B may grant the Purchase Right to Party A. For the purpose of this Agreement, the "person" stipulated herein refers to individual, corporation, joint venture, partnership, enterprise, trust or non-corporation organization.

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1.2 Procedure

The exercise of the Purchase Right by Party A shall be subject to the laws and regulations of the PRC. When Party A intends to exercise the Purchase Right, it shall issue a written notice (the "**Purchase Notice**") to Party B which shall contain the following items: (a) Party A intends to exercise the Purchase Right; (b) the percentage of the Equity Interest to be purchased therewith (the "**Purchased Equity Interest**"); and (c) the effective date or transfer date.

1.3 Transfer Fee

The Transfer Fee ("**Transfer Fee**") shall be confirmed by and between Party A and Party B through negotiation according to the appraisal of the Equity Interest approved by the competent authority, and it shall be the lowest price allowable by the PRC laws and regulations. Party B hereby unconditionally and irrevocably agrees that, in the event that Party A exercises its Purchase Right, Party B shall unconditionally refund to Party A the Transfer Fee in full.

1.4 Transfer of the Equity Interest

Each time when Party A exercises the Purchase Right:

1.4.1 Party B shall procure that Party C timely convene a shareholders' meeting and shall pass the shareholders' resolutions that Party B could transfer to Party A or the Specified Person the Equity Interest.

1.4.2 Party B shall enter into Equity Transfer Agreement with Party A (or the Specified Person, if applicable) in accordance with this Agreement and Purchase Notice.

1.4.3 Related parties shall execute all other necessary agreements or documents, and obtain all necessary government approvals and consents, and take all necessary actions to lawfully transfer the title to the Equity Interests to Party A or the Specified Person and procure Party A or the Specified Person to be registered as the holder of the Equity Interest. The Equity Interest should be free from any Security Interest. For the purpose of this Agreement, Security Interest shall include guarantee, mortgage, any third party's right or interest, any purchase right, pre-emption right, offset right and any other security arrangements. Notwithstanding the foregoing, the Security Interest shall not include any security interest accrued in accordance with this Agreement and the Equity Interest Pledge Agreement which is entered into by and between Party B and Party A on December 1, 2015 ("**Equity Interest Pledge Agreement**"). According to the Equity Interest Pledge Agreement, Party B shall pledge all the equity possessed by Party B in Party C to Party A as a guarantee to the performance of the Exclusive Technical Consulting and Service Agreement which is entered into by and between Party C and Party A on December 1, 2015 ("**Exclusive Technical Consulting and Service Agreement**").

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1.5 Payments for the Equity Interest

1.5.1 Party A shall pay the Transfer Fee to Party B in accordance with Article 1.3 hereof.

2. Warranties Relating to the Equity Interest

2.1 Party C hereby guarantees that:

2.1.1 Absent prior written consent of Party A or the Specified Person, Party C will not supplement, amend, or modify any provision of the Articles of Association of the company, and shall not increase or decrease its registered capital, or alter the equity structure in other methods.

2.1.2 Party C shall be legally existing, and prudently and efficiently operates its business and deals with corporate affairs in accordance with commercial standards and practice.

2.1.3 Absent prior written consent of Party A or the specific person, Party C shall not sell, transfer, mortgage or dispose of any asset, business or beneficial right of Party C, or allow creation of any other Security Interest.

2.1.4 Absent prior written consent of Party A or the specific person, Party C shall not incur, inherit, guarantee or bear any debt except for (i) the debt is incurred during the routine business instead of loan; and (ii) the debt has been disclosed to Party A and has obtained Party A's written consent.

2.1.5 Party C shall operate its routine business to keep the value of its assets, and shall not result in any material influence on its business operation and the value of its asset by acts or omissions.

2.1.6 Absent prior written consent of Party A or the specific person, Party C shall not enter into any material agreement except for the purpose of routine business operation. (For the purpose of this provision, an agreement covering an amount in excess of RMB100,000 shall be deemed as a material agreement).

2.1.7 Absent prior written consent of Party A or the specific person, Party C shall not provide any loan or credit to any third party.

2.1.8 Party C shall provide all materials relating to its operation and financial status to Party A upon Party A's request.

2.1.9 Party C shall effect and maintain insurance from the insurance company acceptable to Party A. The amount and types of such insurance shall be the same with the alike companies which operate the similar business and possess the similar assets with Party C in the same distraction.

2.1.10 Absent prior written consent of Party A or the specific person, Party C shall not merge with, combine with or purchase any entity or make investments to any entity.

2.1.11 Party C shall promptly inform Party A of any existing or potential litigation, arbitration, or administrative procedure in relation to Party C's assets, business and revenue.

2.1.12 Party C shall make all necessary efforts to maintain the title to its assets, including but not limited to execute all necessary or proper documents, commence all necessary or proper claims, or make all necessary or proper defences to all claims.

2.1.13 Absent prior written consent of Party A, Party C shall not distribute any dividend to any shareholder. Nevertheless, Party C shall immediately distribute all payable dividends to the shareholders upon request of Party A or the specified person.

2.2 Party B hereby guarantees that:

2.2.1 Absent prior written consent of Party A or the specific person, Party B shall not sell, transfer, mortgage or dispose of any right or interest relating to the Equity Interest, or allow any creation of other Security Interest on the Equity Interest. However the Security Interest accrued from this Agreement and the Equity Interest Pledge Agreement shall be excluded.

2.2.2 Party B shall promptly inform Party A of any existing or potential litigation, arbitration, or administrative procedure in relation to the Equity Interest.

2.2.3 Party B shall make all necessary efforts to maintain its title to the equity of Party C, including but not limited to execute all necessary or proper documents, commence all necessary or proper claims, or make all necessary or proper defences to all claims.

2.2.4 Upon the request of Party A, Party B shall immediately transfer its Equity Interest to Party A or the Specified Person unconditionally at any time.

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2.2.5 Party B shall strictly comply with and duly perform this Agreement and any other agreements entered into by and between Party B, Party C, and Party A collectively or respectively and shall not affect the validity and enforceability of such agreements by acts or omissions.

3. Representations and Warranties

3.1 Party B and Party C hereby collectively and respectively represent and warrant to Party A that on and till the execution date of this Agreement and each and every transfer day thereafter:

3.1.1 It has the authority and ability to enter into and duly perform this Agreement and each and every Equity Transfer Agreement executed thereafter by Party B or Party C collectively or respectively. Such Agreements shall be legally and effectively binding on the parties thereof and shall be enforceable in accordance with the provisions thereof.

3.1.2 The execution, delivery and performance of this Agreement or any Equity Transfer Agreement thereafter shall not: (i) violate any PRC laws; (ii) conflict with its Articles of Association or other organizational documents; (iii) breach any contract or document of which Party B and/or Party C is a party or which binds Party B and/or Party C; (iv) violate any acquired permit, approval or any valid qualification thereof; or (v) result in the ceasing or revocation or additional conditions to the acquired permit or approval.

3.1.3 Party B retains full and transferable title to its assets and facilities and absent any security interest other than the security interest accrued in this Agreement and the pledge set by the Equity Interests Pledge Agreement.

3.1.4 Party B or any person designated by Party B shall unconditionally transfer any funds obtained from Party C in full to Party A (including but not limited to dividends, bonus, other rights, earnings and so forth distributed by Party C.)

3.1.5 Prior to Party A's lawful exercise of Purchase Right, Party B shall not request Party C to distribute any dividend, bonus and other right and earning and so forth absent Party A's permit.

3.1.6 Party C has no outstanding debt except for (i) the legal debt, which is incurred during its routine business operation instead of loan; (ii) the debt has been disclosed to Party A and has obtained Party A's written permit.

3.1.7 Party C shall comply with all applicable laws and regulations relating to equity transfer.

3.1.8 There is no existing, pending or potential litigation, arbitration, or administrative procedure in relation to the Equity Interest, assets of Party C and other matters of Party C.

3.2 Party A hereby represents and warrants to Party B and Party C on the execution date of this Agreement and each transfer day thereafter:

(i) Party A shall be obligated to provide continual financial support to Party C in the event that Party C requires to obtain funds support for business operation;

(ii) In the event that Party C fails to repay the funds provided by Party A due to Party C's operation losses, Party A hereby agrees to forego the right to seek repayment.

4. Effective Date

This Agreement shall take effect upon execution by the Parties ("Effective Date"), the term shall be ten (10) years, and it may be extended by another ten (10) years if Party A so requires.

5. Governing Law and Dispute Resolution

5.1 Governing Law

This Agreement shall be governed by and construed in accordance with PRC laws.

5.2 Dispute Resolution

With regards to any dispute in relation to the interpretation or implementation of this Agreement, the Parties shall negotiate friendly to settle the dispute. If it can not be settled within thirty (30) days from the date any party issuing written notice requesting settlement of dispute through negotiation, each party has the right to submit it to China International Economic and Trade Arbitration Committee for arbitration according to the valid arbitration rules. The arbitration shall be held in Beijing. The arbitration award shall be final and binding on each party.

6. Tax and Expenditures

Each party shall bear its own tax, costs and expenditures relating to preparing for and executing this Agreement and Equity Transfer Contract and relating to completing the contemplated deal.

7. Notice

Any notice or other communication under this Agreement shall be in Chinese and be sent to the address listed below or other address as may be designated from time to time by personal delivery or mail or facsimile. Any notice required or given hereunder shall be deemed to have been served: (a) the same date if sent by personal delivery; (b) the tenth date from delivery (subject to the stamp) of a prepaid air-mail, or the fourth date from delivering to a professional delivery company acknowledged worldwide if sent by mail; and (c) the receipt date recorded on the transmission confirmation notice if sent by facsimile.

Party A: Recon Hengda Technology (Beijing) Co., Ltd.

Address: Room5771, Floor 5, Shenchang Building, Courtyard 51, Zhichun Road, Haidian District, Beijing, China.

Party B: HUANG Baokun, SHI Jing, LI Suzhen.

Address: Courtyard 0467, Huancheng Road, Huatugou Town, Mangya District, Qinghai, China.

Party C: Qinghai Huayou Underground Petroleum Technology Co., Ltd.

Address: Courtyard 0467, Huancheng Road, Huatugou Town, Mangya District, Qinghai, China.

8. Confidentiality

8.1 The Parties acknowledge and confirm that any oral or written information relating to this Agreement communicated among the Parties shall be deemed as confidential information ("Confidential Information"). The Parties shall keep confidential of such Confidential Information and shall not disclose to any third party unless having obtained prior written consent from the other parties. Nevertheless, Confidential Information shall not include information which (a) was at the date hereof or subsequently becomes public information (otherwise than disclosed by any party received such Confidential Information); (b) is disclosed in accordance with applicable laws or regulations; or (c) the party who discloses any Confidential Information to its attorneys or financial advisors who need to access such information shall ensure that such attorneys or financial advisors comply with this provision and keep confidential such information. The disclosure by the employee or agent of Each Party shall be deemed as disclosed by the party itself, and the party shall be liable of the breach. The Parties agree that the provisions of this Article shall survive notwithstanding the termination of this Agreement.

9. Further Assurance

9.1 The Parties agree that they will, without any hesitation, execute any necessary documents for the performance of this Agreement or any documents which are benefit for the purpose of this Agreement, and will take all necessary actions for the purpose of this Agreement or take actions which are benefit for the purpose of this Agreement.

10. Miscellaneous

10.1 Amendment and supplementation

Any revision, amendment and supplementation of this Agreement shall be in writing and be executed by Each Party.

10.2 Compliance with laws and regulations

The Parties shall comply with all applicable PRC laws and regulations which have been formally issued and may be publicly acquired.

10.3 Entire agreement

Unless it is otherwise revised, amended or supplemented after execution of this Agreement, this Agreement constitutes the entire agreement among the parties as to the subject matter, and supersedes any prior oral or written negotiations, statements or agreement among the parties relating thereto.

10.4 Headings

Headings in this Agreement are only set out for reading convenience, and shall not be used to interpret, explain or otherwise influence the meaning of the provisions of this Agreement.

10.5 Language

This Agreement is made in Chinese and English in three originals. The Chinese version will prevail in the event of any inconsistency between the English and any Chinese translations thereof.

10.6 Severability

If any of the terms of this Agreement is declared invalid, illegal or unenforceable in accordance with any applicable laws or regulations, the validity and enforceability of the other terms hereof shall nevertheless remain unaffected, and the Parties hereto agree to, through friendly negotiation, make valid terms to such invalid, illegal or unenforceable terms, and the economic results from such valid terms shall be close to, as much as may be possible, the superseded invalid, illegal or enforceable terms.

10.7 Successor

This Agreement shall bind the successor of each party or the transferee permitted by the other parties and shall be interpreted for its benefit.

10.8 Continue to be effective

10.8.1 Any duties occurred in relation to the Agreement before expiration or early termination of the Agreement shall continue to be effective after expiration or early termination of the Agreement.

10.8.2 Articles 5, 7, 8 and 10.8 hereof shall survive notwithstanding the termination of this Agreement.

10.9 Waiver

Each party may waive the terms and conditions under this Agreement in writing. Such waiver should be duly signed by the other parties. Any waive relating to the breach of the other party in certain circumstance shall not be deemed as that the waiver party has made waiver to the other party for the same breach in other circumstances.

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This page is the signing page of this Exclusive Equity Interest Purchase Agreement. **IN WITNESS WHEREOF**, the Parties have its authorized representative executed this Agreement on the date first above written.

Party A: Recon Hengda Technology (Beijing) Co., Ltd.

Legal Representative: /s/ Chen Guangqiang

Party B:

HUANG Baokun

Signature: /s/ Huang Baokun

SHI Jing

Signature: /s/ Shi Jing

LI Suzhen

Signature: /s/ Li Suzhen

Party C: Qinghai Hua You Downhole Technology Co., Ltd.

Legal Representative: /s/ Haung Baokun

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EQUITY INTEREST PLEDGE AGREEMENT

THIS EQUITY INTEREST PLEDGE AGREEMENT “**Agreement**”） is entered into by and between the following parties on December 1, 2015.

Pledgee: Recon Hengda Technology (Beijing) Co., Ltd. (“Party A”)

Registered Address: Room5771, Floor 5, Shenchang Building, Courtyard 51, Zhichun Road, Haidian District, Beijing, China.

Pledgor: HUANG Baokun, SHI Jing, LI Suzhen.

HUANG Baokun ID Num.:

SHI Jing ID Num.:

LI Suzhen ID Num.:

WHEREAS:

1. Party A is a wholly foreign-owned enterprise duly established and valid existing under the PRC laws. Party A is permitted by the competent authority to conduct business in the following categories: research and development of computer software and network communication software, technology transfer, technical consulting, technology services, and computer training. Party A and Qinghai Hua You Downhole Technology Co., Ltd. (“**QINGHAI HUAYOU**”), owned by the Pledgor, have entered into an Exclusive Technical Consulting and Service Agreement on December 1, 2015, (the “**Service Agreemen**t”).

2. The Pledgor holds 100% equity interest of QINGHAI HUAYOU, which is a limited liability company duly established and validly existing in Qinghai under the laws of the PRC.

3. In order to ensure the technical consulting and service fee that Party A could collect from QINGHAI HUAYOU, pursuant to the Service Agreement, the Pledgor is willing to pledge all of its equity interest in QINGHAI HUAYOU to the Pledgee as a security for such technical consulting and service fees.

NOW, THEREFORE, through mutual negotiations, the Parties hereto agree as follows:

Article 1 Definitions

Unless otherwise stipulated hereof, for the purpose of this Agreement, the following terms shall have the following meanings:

1.1 Pledge refers to the full meaning assigned to that term in Article 2 of this Agreement.

1.2 Equity Interest refers to the 100% equity interest (the “**Equity Interest**”) in QINGHAI HUAYOU, lawfully held by the Pledgor.

1.3 Rate of Pledge refers to the ratio between the value of the pledge under this Agreement and the technical consulting fees under the Service Agreement.

1.4 Term of Pledge refers to the period provided for under Article 3.2 hereunder.

1.5 Service Agreement refers to the Exclusive Technical Consulting and Service Agreement entered into by and between QINGHAI HUAYOU and Party A on December 1, 2015.

1.6 Default refers to any event enumerated in Article 7 hereto.

1.7 Notice of Default refers to the notice of default issued by the Pledgee in accordance with this Agreement.

Article 2 Pledge

2.1 Party B agrees to pledge all of its Equity Interest in QINGHAI HUAYOU to the Pledgee as a guarantee for the technical consulting service fee payable to the Pledgee under the Service Agreement.

2.2 Pledge right under this Agreement refers to the right owned by the Pledgee who shall be entitled to have priority in receiving payment or proceeds from the auction or sale of the equity interest pledged by the Pledgor to the Pledgee.

Article 3 Rate of Pledge and Term of Pledge

3.1 The Rate of Pledge:

The Rate of Pledge shall be 100% under this Agreement.

3.2 The Term of Pledge

3.2.1 The Pledge of the Equity Interest under this Agreement shall take effect as of the date that the Pledge of the Equity Interest is recorded in the register of shareholders of QINGHAI HUAYOU.

3.2.2 During the Term of Pledge, the Pledgee shall be entitled to foreclose the Pledge in accordance with this Agreement in the event that QINGHAI HUAYOU fails to pay exclusive technical consulting and service fees in accordance with the Service Agreement.

Article 4 Possession of Pledge Documents

4.1 During the Term of Pledge, the Pledgee shall be entitled to possess the contribution certificate of the Equity Interest (the "**Contribution Certificate**") and the register of shareholders of QINGHAI HUAYOU. The Pledgor shall deliver the Contribution Certificate and the register of shareholders hereunder to the Pledgee within one week of the execution of this Agreement.

4.2 The Pledgee shall be entitled to collect dividends of the Equity Interest.

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Article 5 Representations and Warranties of Party B

5.1 Party B is the lawful holder of the Equity Interest.

5.2 The Pledgee shall not be interfered with by any third party at any time when the Pledgee exercising its rights in accordance with this Agreement.

5.3 The Pledgee shall be entitled to exercise or assign the Pledge in accordance with this Agreement.

5.4 The Pledgor shall not pledge or encumber the Equity Interest to any third party except for the Pledgee.

Article 6 Covenants of the Pledgor

6.1 During the term of this Agreement, the Pledgor covenants to the Pledgee that the Pledgor shall:

6.1.1 Except for the transfer of the Equity Interest to the Pledgee or the specified person designated by the Pledgee ("**Specified Person**") as subject to the Exclusive Equity Interest Purchase Agreement entered into by and among the Party A, Party B and QINGHAI HUAYOU on December 1, 2015, not transfer or assign the Equity Interest, create or permit to be created any pledges which may have an adverse effect on the rights or benefits of the Pledgee without prior written consent from the Pledgee.

6.1.2 Comply with and implement laws and regulations with respect to the pledge of equity interest, Comply with the notices, orders or suggestions with respect to the Pledge issued or made by the competent authority after receiving the same, or raise objection to such notices, orders or suggestions at the reasonable request or with the consent of the Pledgee.

6.1.3 Timely notify the Pledgee of any event or any notice which may affect the Pledgor's Equity Interest or any part of its right, and any event or notice which may alter or affect any of the Pledgor's covenants and obligations hereunder.

6.2 The Pledgor agrees that the Pledgee's right to exercise the Pledge obtained from this Agreement shall not be suspended or hampered through legal procedure by the Pledgor, any successors of the Pledgor, any person authorized by the Pledgor or any other third party.

6.3 The Pledgor warrants to the Pledgee that in order to protect or perfect the security on the payments of the technical consulting and service fees under the Service Agreement, the Pledgor shall execute in good faith and procure other parties who have interests in the Pledge to execute all title certificates, contracts upon the request of the pledgee, and/or perform and procure other parties who have interests to take action as required by the Pledgee and provide access to exercise the rights and authorization vested in the Pledgee under this Agreement, and execute all the documents with respect to the alternations of certificate of the Equity Interest with the Pledgee or the person (individual or legal entity) designated by the Pledgee, and provide all notices, orders and decisions deemed necessary by the Pledgee to the Pledgee within a reasonable time.

6.4 The Pledgor warrants to the Pledgee that the Pledgor will comply with and perform all the guarantees, covenants, agreements, representations and conditions for the benefits of the Pledgee, fail so performing, the Pledgor shall compensate all the losses therefore suffered by the Pledgee.

Article 7 Default

7.1 The events enumerated below shall be deemed as default:

7.1.1 QINGHAI HUAYOU fails to make full payments of the exclusive technical consulting and service fees as scheduled under the Service Agreement.

7.1.2 The Pledgor makes any material misleading or fraudulent representations or warranties under Article 5 herein, and/or the Pledgor is in violation of any warranties under Article 5 herein.

7.1.3 The Pledgor violates any covenant under Article 6 herein.

7.1.4 The Pledgor violates any term or condition herein.

7.1.5 The Pledgor waives the pledged Equity Interest or transfers or assigns the pledged Equity Interest without prior written consent of the Pledgee, except as provided in Article 6.1.1 in this Agreement.

7.1.6 Any external loan, security, compensation, covenant or other compensation liabilities of the Pledgor's (1) is required to be repaid or performed prior to the due date due to default; or (2) is due but cannot be repaid or performed as scheduled and thereby cause the Pledgee to deem that the Pledgor's capacity to perform the obligations herein is affected.

7.1.7 The Pledgor is incapable of repaying its general debt or other debt.

7.1.8 This Agreement becomes illegal or the Pledgor is incapable to continue to perform obligations herein for the reason of the promulgation of the related laws.

7.1.9 Any approval, permit or authorization of the competent authority in associated with the enforcement and validity of this Agreement is withdrawn, suspended, invalidated or materially revised.

7.1.10

The property of the Pledgor adversely changes and causes the Pledgee to deem that the capability of the Pledgor to perform the obligations herein is affected.

7.1.11 The successors or assignees of QINGHAI HUAYOU are only entitled to perform a portion of or refuse to perform the liability to pay under the Service Agreement.

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7.1.12 Other circumstances whereby the Pledgee is incapable of exercising the right to foreclose on the Pledge in accordance with the related laws.

7.2 Party B should immediately notify Party A in writing of the occurrence of any event under Article 7.1 herein or any events that may result in the foregoing events upon his knowledge.

7.3 Unless the Default under Article 7.1 herein has been remedied to the Pledgee's satisfaction, the Pledgee, at any time when the Event of Default occurs or thereafter, may issue a written notice of default to the Pledgor and require the Pledgor immediately make full payments of the outstanding service fees under the Service Agreement and other payables or foreclose on the Pledge in accordance with Article 8 herein.

Article 8 Rights of the Pledgee

8.1 The Pledgor shall not transfer or assign the Equity Interest without prior written approval from the Pledgee prior to the full repayment of the consulting and service fees under the Service Agreement.

8.2 The Pledgee shall serve the Notice of Default on the Pledgor when it exercises the right of pledge.

8.3 The Pledgee may exercise the right to foreclose on the Pledge at any time when the Pledgee serves the Notice of Default pursuant to Article 7.3

8.4 The Pledgee is entitled to have priority in receiving payments or proceeds from the auction or sale of whole or part of the Equity Interest pledged herein in accordance with applicable law until the outstanding technical consulting and service fees and all other payables under the Service Agreement are repaid.

8.5 The Pledgor shall not hinder the Pledgee from foreclosing on the Pledge in accordance with this Agreement and shall provide necessary assistance for the foreclosure of Pledge.

Article 9 Transfer or Assignment

9.1 The Pledgor shall not confer or transfer any right or obligation herein to any third party without the prior written consent of the Pledgee.

9.2 This Agreement shall be binding and enforceable on Pledgee and each of his successors and assignees.

9.3 The Pledgee may transfer or assign all or any of his rights and obligations under the Service Agreement to any person (individual or legal entity) designated by him at any time. In this case, the assignee shall enjoy and undertake all rights and obligations herein of the Pledgee as if the assignee is a party hereto. Where the Pledgee transfers or assigns the rights and obligations under the Service Agreement, the Pledgor shall execute the relevant agreements and/or documents with respect to such transfer or assignment at the request of the Pledgee.

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9.4 Where the Pledgee transfers or assigns the pledge to a third party, the new parties to the pledge shall re-execute a pledge contract.

Article 10 Termination

10.1 This Agreement shall not be terminated until the consulting and service fees under the Service Agreement are paid in full and QINGHAI HUAYOU no longer undertakes any obligation under the Service Agreement.

Article 11 Formalities Fees and Other Expenses

11.1 The Pledgor shall be responsible for all the fees and actual expenditures in relation to this Agreement, including but not limited to legal fees, cost of production, stamp tax and any other taxes and charges. If the Pledgee pays the relevant taxes and fees in accordance with laws, the Pledgor shall fully indemnity such taxes and fees paid by the Pledgee.

11.2 The Pledgor shall be responsible for all the fees (including but not limited to any taxes, formalities fees, management fees, litigation fees, attorney's fees, and various insurance premiums in connection with disposition of the Pledge) incurred by the Pledgor for the reason that the Pledgor fails to pay any payable taxes, fees or charges in accordance with this Agreement, or the Pledgee has recourse to any forgoing taxes, charges or fees by any means for other reasons.

Article 12 Force Majeure

12.1 If the fulfilment of this Agreement is delayed or prevented due to the Force Majeure Events, the party affected by such a Force Majeure Event shall free from any obligation to the extent of delay or holdback. Force Majeure refers to any event beyond control of the affected party and unavoidable with reasonable caution, which shall include but not limited to, government acts, nature disasters, fire, explosion, typhoon, flood, earthquake, tidal wave, lightning or war. However, any lack of credit, assets or financing shall not be deemed as an event beyond control of a Party. The party claiming the Force Majeure and seeking a waiver of its obligations hereunder shall promptly inform the other party of the Force Majeure and the procedure to fulfil its obligations hereunder.

12.2 If performance of this Agreement is delayed or prevented due to Force Majeure set forth in the preceding paragraph, the affected party shall not subject to any liability hereunder arising from the performances so delayed or prevented. The affected party shall make reasonalbe effort to reduce or diminish the effect from such Event, and shall make reasonable efforts to resume its performance. Both parties shall resume the performance with best effort upon elimination of such Event.

Article 13 Dispute Settlement

13.1 This Agreement shall be governed by and construed in all respects in accordance with the laws of the PRC.

13.2 The Parties shall strive to settle any dispute arising from the interpretation or performance, or in connection with this Agreement through friendly negotiation. In case no settlement can be reached through negotiation, each Party can submit such matter to China International Economic and Trade Arbitration Committee for arbitration according to its currently effective arbitration rules. The arbitration shall be held in Beijing. The arbitration proceedings shall be conducted in Chinese. The arbitration awards shall be final and binding upon the Parties. The arbitration awards may be submitted to the applicable People's Court for enforcement.

Article 14 Notices

14.1 Any notice to which is given by the both Parties hereto regarding the rights and obligations hereunder shall be in writing. Where such notice is delivered personally, the time of notice is the time when such notice actually reaches the addressee; where such notice is transmitted by telex or facsimile, the notice time is the time when such notice is transmitted. If such notice does not reach the addressee on business date or reaches the addressee after the business time, the next business day following such day is the date of notice. The delivery place is the address first written above of the Parties hereto or the address advised in writing including, inter alias, facsimile and telex from time to time.

Article 15 Appendix

15.1 The Appendix of this Agreement as attached hereto is parts of this Agreement.

Article 16 Effectiveness

16.1 This Agreement and any amendments, supplements and modifications of this Agreement shall be in writing, and come into effect upon being executed by the Parties thereto.

16.2 This Agreement is executed both in Chinese and English with four copies for each language. The Chinese version shall prevail in the event of any inconsistency between the English and any Chinese versions thereof.

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This page is the signing page of this Equity Interest Pledge Agreement.

IN WITNESS WHEREOF, the undersigned have executed this Agreement as of the date first set forth above written.

Party A: Recon Hengda Technology (Beijing) Co., Ltd.

Legal Representative: /s/ Chen Guangqiang

Party B:

HUANG Baokun

Signature: /s/ Huang Boakun

SHI Jing

Signature: /s/ Shi Jing

LI Suzhen

Signature: /s/ Li Suzhen

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APPENDIX

1. The register of the shareholders of QINGHAI HUAYOU

2. The Contribution Certificate of QINGHAI HUAYOU

3. The Exclusive Technical Consulting and Service Agreement.

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Power of Attorney

I, the undersigned, HUANG Baokun, Chinese nationality, ID Num.: hold 53% equity interest in Qinghai Huayou DownholeTechnology Co., Ltd. ("**QINGHAI HUAYOU**"). As a shareholder of QINGHAI HUAYOU, I hereby irrevocably entrust Recon Hengda Technology (Beijing) Co., Ltd .. ("**RECON HENGDA**") to execute the following rights during the term of this Power of Attorney:

I, the undersigned, exclusively authorize RECON HENGDA as the sole representative with full authority to perform shareholder's rights upon the equity interest I hold, including but not limited to: (i) the attendance of the shareholder's meeting and the execution of relative Shareholder Resolution(s) of QINGHAI HUAYOU for and on behalf of me; (ii) the performance of all my rights associated with the ownership of equity conferred by laws and Articles of Association of QINGHAI HUAYOU including but not limited to voting-rights and the rights of assigning, transferring, pledging or disposing of such equity interest partially or wholly; and (iii) the designations and appointments of Legal Representative, Chief Executive Director, Directors, Supervisors, General Manager and/or other Officer(s) of QINGHAI HUAYOU on my behalf.

RECON HENGDA is entitled to execute the Transfer Agreement mentioned in the Exclusive Equity Interest Purchase Agreement within its authority and duly perform the Equity Interest Pledge Agreement and the Exclusive Equity Interest Purchase Agreement that are entered into simultaneously with this Power of Attorney by me. The execution of the abovementioned rights shall not constitute any limitation on this Power of Attorney.

Save as otherwise provided hereunder, RECON HENGDA is entitled to exercise all the necessary rights arising from the equity interest upon its own discretions without any oral or written instructions of me.

All acts associated with my equity interest in QINGHAI HUAYOU conducted by RECON HENGDA shall be deemed as the acts of me. All documents executed by RECON HENGDA shall be deemed as executed by me, I shall acknowledge such documents.

RECON HENGDA is entitled to assign all rights under this Power of Attorney. RECON HENGDA is entitled to entrust any other individual(s) or legal entity(s) to execute the above rights and equity interest without issuing any notice to or obtaining any prior consent from me. Nevertheless, RECON HENGDA shall report to me immediately after such assignment and the assignment shall not harm any of my rights or vested interests in any event.

1

This Power of Attorney shall be irrevocable and continuously valid so long as I am a shareholder of QINGHAI HUAYOU and shall come into effect as of the date set forth below.

During the term of this Power of Attorney, in the event that I intend to perform the rights hereunder, I shall negotiate with YANKONG HENGDA in advance.

HUANG Baokun

Signature: /s/ Huang Baokun

Date: December 1, 2015.

2

Power of Attorney

I, the undersigned, SHI Jing, Chinese nationality, ID Num.: hold 40% equity interest in Qinghai Huayou Downhole Technology Co., Ltd. ("**QINGHAI HUAYOU**"). As a shareholder of QINGHAI HUAYOU, I hereby irrevocably entrust Recon Hengda Technology (Beijing) Co., Ltd. ("**RECON HENGDA**") to execute the following rights during the term of this Power of Attorney:

I, the undersigned, exclusively authorize RECON HENGDA as the sole representative with full authority to perform shareholder's rights upon the equity interest I hold, including but not limited to: (i) the attendance of the shareholder's meeting and the execution of relative Shareholder Resolution(s) of QINGHAI HUAYOU for and on behalf of me; (ii) the performance of all my rights associated with the ownership of equity conferred by laws and Articles of Association of QINGHAI HUAYOU including but not limited to voting-rights and the rights of assigning, transferring, pledging or disposing of such equity interest partially or wholly; and (iii) the designations and appointments of Legal Representative, Chief Executive Director, Directors, Supervisors, General Manager and/or other Officer(s) of QINGHAI HUAYOU on my behalf.

RECON HENGDA is entitled to execute the Transfer Agreement mentioned in the Exclusive Equity Interest Purchase Agreement within its authority and duly perform the Equity Interest Pledge Agreement and the Exclusive Equity Interest Purchase Agreement that are entered into simultaneously with this Power of Attorney by me. The execution of the abovementioned rights shall not constitute any limitation on this Power of Attorney.

Save as otherwise provided hereunder, RECON HENGDA is entitled to exercise all the necessary rights arising from the equity interest upon its own discretions without any oral or written instructions of me.

All acts associated with my equity interest in QINGHAI HUAYOU conducted by RECON HENGDA shall be deemed as the acts of me. All documents executed by RECON HENGDA shall be deemed as executed by me, I shall acknowledge such documents.

RECON HENGDA is entitled to assign all rights under this Power of Attorney. RECON HENGDA is entitled to entrust any other individual(s) or legal entity(s) to execute the above rights and equity interest without issuing any notice to or obtaining any prior consent from me. Nevertheless, RECON HENGDA shall report to me immediately after such assignment and the assignment shall not harm any of my rights or vested interests in any event.

1

This Power of Attorney shall be irrevocable and continuously valid so long as I am a shareholder of QINGHAI HUAYOU and shall come into effect as of the date set forth below.

During the term of this Power of Attorney, in the event that I intend to perform the rights hereunder, I shall negotiate with RECON HENGDA in advance.

SHI Jing

Signature: /s/ Shi Jing

Date: December 1, 2015.

2

Power of Attorney

I, the undersigned, LI Suzhen, Chinese nationality, ID Num.: hold 7% equity interest in Qinghai Hua You Downhole Technology Co., Ltd. ("**QINGHAI HUAYOU**"). As a shareholder of QINGHAI HUAYOU, I hereby irrevocably entrust Recon Hengda Technology (Beijing) Co., Ltd. ("**RECON HENGDA**") to execute the following rights during the term of this Power of Attorney:

I, the undersigned, exclusively authorize RECON HENGDA as the sole representative with full authority to perform shareholder's rights upon the equity interest I hold, including but not limited to: (i) the attendance of the shareholder's meeting and the execution of relative Shareholder Resolution(s) of QINGHAI HUAYOU for and on behalf of me; (ii) the performance of all my rights associated with the ownership of equity conferred by laws and Articles of Association of QINGHAI HUAYOU including but not limited to voting-rights and the rights of assigning, transferring, pledging or disposing of such equity interest partially or wholly; and (iii) the designations and appointments of Legal Representative, Chief Executive Director, Directors, Supervisors, General Manager and/or other Officer(s) of QINGHAI HUAYOU on my behalf.

RECON HENGDA is entitled to execute the Transfer Agreement mentioned in the Exclusive Equity Interest Purchase Agreement within its authority and duly perform the Equity Interest Pledge Agreement and the Exclusive Equity Interest Purchase Agreement that are entered into simultaneously with this Power of Attorney by me. The execution of the abovementioned rights shall not constitute any limitation on this Power of Attorney.

Save as otherwise provided hereunder, RECON HENGDA is entitled to exercise all the necessary rights arising from the equity interest upon its own discretions without any oral or written instructions of me.

All acts associated with my equity interest in QINGHAI HUAYOU conducted by RECON HENGDA shall be deemed as the acts of me. All documents executed by RECON HENGDA shall be deemed as executed by me, I shall acknowledge such documents.

RECON HENGDA is entitled to assign all rights under this Power of Attorney. RECON HENGDA is entitled to entrust any other individual(s) or legal entity(s) to execute the above rights and equity interest without issuing any notice to or obtaining any prior consent from me. Nevertheless, RECON HENGDA shall report to me immediately after such assignment and the assignment shall not harm any of my rights or vested interests in any event.

1

This Power of Attorney shall be irrevocable and continuously valid so long as I am a shareholder of QINGHAI HUAYOU and shall come into effect as of the date set forth below.

During the term of this Power of Attorney, in the event that I intend to perform the rights hereunder, I shall negotiate with RECON HENGDA in advance.

LI Suzhen

Signature: /s/ Li Suzhen

Date: December 1, 2015.

2

EXCLUSIVE TECHNICAL CONSULTING AND SERVICE AGREEMENT

THIS EXCLUSIVE TECHINCAL CONSULTING AND SERVICE AGREEMENT the “**Agreement**”）is made and entered into as of December 1, 2015 by and between the following parties:

Party A: Recon Hengda Technology (Beijing) Co.,Ltd.

Registered Address: Room5771, Floor 5, Shenchang Building, Courtyard 51, Zhichun Road, Haidian District, Beijing, China.

Party B: Qinghai Hua You Downhole Technology Co., Ltd.

Registered Address: Courtyard 0467, Huancheng Road, Huatugou town, Mangya District, Qinghai, China.

WHEREAS,

1. Party A, a wholly foreign-owned enterprise duly established and validly existing under the laws of the People’s Republic of China (the “**PRC**”), owns resources to provide relevant technical consulting and services.

2. Party B is a limited liability company duly established and validly existing under the laws of the PRC. Party A agrees to provide to Party B technology consulting and related services, and Party B agrees to accept such services provided by Party A in accordance with this Agreement.

NOW THEREFORE, through mutual negotiations, the Parties hereto agree as follows:

1. **Technical Consulting and Services, Sole and Exclusive Interests**

1.1 During the term of this Agreement, Party A agrees to provide to Party B the technical consulting and services and other significant resources necessary for the operation of Party B's business in accordance with this Agreement, including but not limited to:

(1) Provision of services for research and development of computer software and network communication software, technology transfer, technical consulting, technology services, and computer training.

(2) Provision of intellectual property (such as trademark, patent, know-how and so forth) which is solely owned by Party A and necessary for the operation and development of Party B's business;

(3) Secondment to Party B of senior management personnel and senior technical personnel;

(4) Human resource consulting;

(5) Legal issue consulting;

(6) Finance consulting and support;

(7) Investment consulting and management;

(8) Other consulting and services required by Party B in associate with the variation of market.

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1.2 Party B hereby agrees to accept such technical consulting and services provided by Party A. Party B further agrees that, during the term of this Agreement, it shall not accept the technical consultation and service provided by any third party other than Party A without the prior written consent of Party A.

1.3 Party A shall be the sole and exclusive owner of all right, title and interests and intellectual property rights arising from this Agreement (including but not limited to, copyrights, patent, know-how, commercial secrets and so forth), regardless of whether it is developed by Party A or by Party B based on Party A's intellectual property right.

2. Payments for the technical consultation and service ("Consulting Fees")

2.1 Both parties agree that the Consulting Fees shall be paid every quarter in accordance with the consulting and service actually provided by Party A. Party A has the right, solely at its discretion, to determine the amount of the Consulting Fees, and both parties agree to, at Party A's discretion, amend or enter into supplementary agreement in respect of the provisions under this Agreement regarding Consulting Fees. The Consulting Fees could be 100% of Party B's quarterly profit.

2.2 Except for the Consulting Fees mentioned in the preceding paragraph, Party B agrees to reimburse Party A for all necessary expenses in relation to performing this Agreement, including but not limited to, travelling expenses, service fees, and out-of-pocket expenses, etc.

2.3 Except for the Consulting Fees, Party B agrees to reimburse Party A the tax, customs and other expenditures (income tax is not included) paid by Party A in favour of Party B in relation to this Agreement.

2.4 Party B shall provide Party A with a report in relation to the Consulting Fees ("**Consulting Fees Report**") in accordance with this Agreement within three (3) business days after each quarter and Party B shall remit the amount in RMB to the bank account designated by Party A within two (2) business days after delivering such Consulting Fees Report.

2.5 Party B shall maintain a separate bank account for the Consulting Fees under this Agreement. Party A is entitled to appoint its employees or PRC or international accountants to review or audit the account books in relation to the consulting service from time to time. The fees payable to the accountant shall be paid by Party A itself. Party B shall provide to Party A's employees or accountants any convenience and assistance required and all documents, account books, records, materials and information deemed necessary by such persons. The auditing report issued by Party A's employee shall be final and conclusive unless Party B issues written objection within seven (7) days after receiving such report. The report issued by the accountant shall be final and conclusive. Party A is entitled to serve written payment notice on Party B at any time after receiving the audit report according to the consulting fee confirmed by the audit report. Party B shall pay within seven (7) days after receiving the notice in accordance with Article 2.4.

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2.6 All payment payable by Party B to Party A shall be after tax, bank handing charge or any other expenses.

3. Representations and Warranties

3.1 Party A hereby represents and warrants as follows:

3.1.1 It has the authority to enter into and perform this Agreement in accordance with its Articles of Association and business scope, and has taken all necessary action to get authorization, consent and approval from third party and/or competent government authorities, and will not conflict with any agreement or laws binding on it.

3.1.2 Upon execution, this Agreement shall constitute a legally binding document on Party A and shall be enforceable in accordance herewith.

3.2 Party B hereby represents and warrants as follows:

3.2.1 Party B is a company duly registered and validly existing under the laws of the PRC and is authorized to enter into this Agreement.

3.2.2 Party B has the authority to execute and perform this Agreement in accordance with its Articles of Association and its business scope, and has taken all necessary action to obtain all consents and approval to execute and perform this Agreement, and that this Agreement will not conflict with any agreement or laws binding on it.

3.2.3 Upon execution, this Agreement shall constitute a legally binding document on Party A and shall be enforceable in accordance herewith.

4 Confidentiality

4.1 Party B agrees to make reasonable efforts to protect and maintain the confidentiality of Party A's confidential data and information acknowledged or received in the exclusive technical consulting and service provided by Party A ("**Confidential Information**"). Party B shall not disclose, grant or transfer to any third party of such Confidential Information. Upon termination of this Agreement, Party B shall, upon Party A's request, return to Party A or destroy of any document, material or software contained any of such Confidential Information, and shall completely delete any of such Confidential Information from any memory device, and shall not use or permit any third party to use such Confidential Information.

4.2 The both Parties agree that the provisions of this Article shall survive notwithstanding the alteration, revocation or termination of this Agreement.

5 Indemnities

5.1 Party B shall indemnify Party A against any loss, damage, liability or expenses suffered by Party A as a result of or arising from any litigation, claim or compensation request in other forms related to the consulting and service under this Agreement.

6 Effectiveness and Term of this Agreement

6.1 This Agreement shall be executed and come into effect as of the date first set forth above. The term of this Agreement shall be thirty (30) years unless earlier terminated as set forth in this Agreement or other written agreements entered into by the parties hereof.

6.2 This Agreement shall be terminated upon written confirmation from both Parties before termination. Otherwise this agreement shall be extended by another thirty (30) years.

7 Termination of the Agreement

7.1 The Agreement shall be extended automatically upon the expiration of this Agreement unless it is terminated in accordance with this Agreement.

7.2 During the term of this Agreement, Party B may not terminate this Agreement except in the case of Party A’s gross negligence, fraud, or other illegal action or bankruptcy of Party A. Notwithstanding the above, Party A may terminate this Agreement with issuing a written notice to Party B thirty (30) days in advance.

7.3 The rights and obligations of the both Parties under Article 4 and Article 5 of this Agreement shall survive after the termination of this Agreement.

8 Dispute Settlement

8.1 With regards to any dispute in relation to the interpretation or implementation of this Agreement, the Parties shall negotiate friendly to settle the dispute. In case no settlement can be reached through consultation, each Party can submit such matter to China International Economic and Trade Arbitration Committee for arbitration according to the current effective arbitration rules. The arbitration shall be held in Beijing. The arbitration proceedings shall be conducted in Chinese. The arbitration award shall be final and binding on the Parties.

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9 Force Majeure

9.1 Force Majeure Event ("**Event**") refers to any event beyond control of the affected party and unavoidable with reasonable caution, which shall include but not limit to, government acts, nature disasters, fire, explosion, typhoon, flood, earthquake, tidal wave, lightning or war. However, any lack of credit, assets or financing shall not be deemed as an event beyond control of a party. The party claiming the Force Majeure and seeking a waiver of its obligations hereunder shall promptly inform the other party the Force Majeure and the procedure to fulfil its obligations hereunder.

9.2 If performance of this Agreement is delayed or prevented due to Force Majeure set forth in the preceding paragraph, the affected party shall not subject to any liability hereunder arising from the obligations so delayed or prevented. The affected party shall make reasonable effort to reduce or diminish the effect from such Event, and shall make reasonable efforts to resume its performance. Both parties shall resume the performance with best effort upon elimination of such Event.

10 Notices

10.1 Any notice by each Party regarding rights and obligations hereunder shall be in writing. Where such notice is delivered personally, the time of notice is the time when such notice actually reaches the addressee; where such notice is transmitted by telex or facsimile, the notice time is the time when such notice is transmitted. If such notice does not reach the addressee on business date or reaches the addressee after the business time, the next business day following such day is the date of notice. The delivery place is the address first written above of the Parties hereto or the address advised in writing including facsimile and telex from time to time. "Writing" includes, inter alia, fax and telefax.

11 Assignment

11.1 Absent the prior written consent of Party A, Party B may not assign any right or obligation hereunder to any third party.

12 Severability

12.1 If any of the terms of this Agreement is invalid, illegal or unenforceable due to incompliance with laws, the validity and enforceability of the other terms hereof shall nevertheless remain unaffected.

13 Amendments and Supplement

13.1 Any amendment and supplement of this Agreement shall be in writing and duly executed by the parties hereto, such amendment and supplement shall be deemed as a part of this Agreement and shall be in full force and effect as this Agreement.

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14 Governing Law and Languages

14.1 This Agreement shall be governed by and construed in accordance with the laws of the PRC.

14.2 This Agreement is executed both in Chinese and English. The Chinese version will prevail in the event of any inconsistency between the English and any Chinese version.

[THIS SPACE IS INTENTIONALLY LEFT BLANK]

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IN WITNESS WHEREOF, the both Parties have its authorized representative executed this Agreement on the date first above written.

Party A: Recon Hengda Technology (Beijing) Co., Ltd.

Legal Representative: /s/ Chen Guangqiang

Party B: Qinghai Hua You Downhole Technology Co., Ltd.

Legal Representative: /s/ Huang Baokun

Annex B

QHHY FINANCIAL STATEMENTS AND NOTES TO FINANCIAL STATEMENTS

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Qinghai Hua You Downhole Technology Co., Ltd.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors
Qinghai Hua You Downhole Technology Co., Ltd.

We have audited the accompanying balance sheets of Qinghai Hua You Downhole Technology Co., Ltd. (the "Company") as of June 30, 2015 and 2014, and the related statements of operations, statements of equity, and statements of cash flows for each of the two years in the period ended June 30, 2015. Qinghai Hua You Downhole Technology Co., Ltd.'s management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Qinghai Hua You Downhole Technology Co., Ltd. as of June 30, 2015 and 2014, and the results of its operations and its cash flows for each of the two years in the period ended June 30, 2015, in conformity with accounting principles generally accepted in the United States of America.

New York, New York
February 16, 2016

Qinghai Hua You Downhole Technology Co., Ltd.

Balance Sheets

	As of December 31,		As of June 30,		
	2015	2015	2014	2015	
	(Unaudited)	(Unaudited)			
ASSETS	RMB	U.S. Dollars	RMB	RMB	U.S. Dollars
Current assets					
Cash and cash equivalents	¥ 395,609	$ 60,950	¥ 420,222	¥ 229,810	$ 35,406
Notes receivable	1,500,000	231,100	-	-	-
Trade accounts receivable	8,152,454	1,256,021	7,980,846	6,424,933	989,868
Other receivables, net	1,565,588	241,205	1,011,000	990,000	152,526
Purchase advances	434,098	66,880	-	1,644,621	253,381
Deferred tax asset	-	-	322,206	-	-
Tax recoverable	-	-	107,486	-	
Total current assets	12,047,749	1,856,156	9,841,760	9,289,364	1,431,181
Property and equipment, net	7,477,531	1,152,038	5,754,452	5,256,978	809,925
Total Assets	¥ 19,525,280	$ 3,008,194	¥ 15,596,212	¥ 14,546,342	$ 2,241,106
LIABILITIES AND EQUITY					
Current liabilities					
Short-term borrowings	¥ 3,500,000	$ 539,233	¥ -	¥ -	$ -
Trade accounts payable	4,184,794	644,737	2,193,103	3,841,973	591,920
Other payables and accrued expenses	389,046	59,939	3,279,352	639,316	98,497
Other payable- related parties	1,791	276	812,098	-	-
Advances from customers	-	-	598,378	-	-
Taxes payable	1,016,780	156,652	-	241,342	37,183
Total current liabilities	9,092,411	1,400,837	6,882,931	4,722,631	727,600
Total Liabilities	9,092,411	1,400,837	6,882,931	4,722,631	727,600
COMMITMENTS AND CONTINGENCIES					
Equity					
Paid-in capital	10,000,000	1,540,666	10,000,000	10,000,000	1,540,666
Additional paid-in capital	104,500	16,100	104,500	104,500	16,100
Retained earnings (accumulated deficit)	328,369	50,591	(1,391,219)	(280,789)	(43,260)
Total equity	10,432,869	1,607,357	8,713,281	9,823,711	1,513,506
Total Liabilities and Equity	¥ 19,525,280	$ 3,008,194	¥ 15,596,212	¥ 14,546,342	$ 2,241,106

The accompanying notes are an integral part of these financial statements.

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Qinghai Hua You Downhole Technology Co., Ltd.

Statements of operations

	For the six months ended December 31,			For the years ended June 30,		
	2014 (Unaudited)	2015 (Unaudited)		2014	2015	
	RMB	RMB	USD	RMB	RMB	U.S. Dollars
Revenues	¥ 7,857,293	¥ 7,483,264	$ 1,152,921	¥ 11,063,965	¥ 12,195,278	$ 1,878,885
Cost of revenues	5,640,468	5,562,076	856,930	7,213,902	8,838,960	1,361,788
Gross profit	2,216,825	1,921,188	295,991	3,850,063	3,356,318	517,097
	** **	** **	** **			** **
General and administrative expenses	874,379	977,910	150,663	2,329,259	1,807,072	278,409
Operating expenses	874,379	977,910	150,663	2,329,259	1,807,072	278,409
	** **	** **	** **			** **
Income from operation	1,342,446	943,278	145,328	1,520,804	1,549,246	238,688
Other income (expenses)						
Interest income	3,449	1,864	287	2,945	6,165	950
Interest expense	(2,166)	(125,529)	(19,340)	(5,121)	(7,545)	(1,162)
Other income (expense)	(15)	(7,402)	(1,140)	(338,843)	1,760	269
						-
Income before income tax	1,343,714	812,211	125,135	1,179,785	1,549,626	238,745
Provision for income tax	335,932	203,053	31,284	382,414	439,196	67,665
Net Income	¥ 1,007,782	¥ 609,158	$ 93,851			

Commercial mortgage loans—Apartments/Multi-Family

	Debt Service Coverage Ratio—September 30, 2012						
	Greater than 2.0X	**1.8X to 2.0X**	**1.5X to <1.8X**	**1.2X to <1.5X**	**1.0X to <1.2X**	**Less than 1.0X**	**Total**

				(in millions)			
Loan-to-Value Ratio							
0%-49.99%	$ 810	$ 259	$ 263	$ 327	$ 104	$ 29	$ 1,792
50%-59.99%	269	90	171	190	28	19	767
60%-69.99%	507	0	271	402	115	16	1,311
70%-79.99%	344	47	267	374	113	0	1,145
80%-89.99%	0	0	0	0	152	52	204
90%-100%	0	0	0	15	2	23	40
Greater than 100%	0	0	0	18	0	35	53
Total Apartments/Multi-Family	$ 1,930	$ 396	$ 972	$ 1,326	$ 514	$ 174	$ 5,312

Commercial mortgage loans—Hospitality

	Debt Service Coverage Ratio—September 30, 2012						
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X (in millions)	1.0X to <1.2X	Less than 1.0X	Total
Loan-to-Value Ratio							
0%-49.99%	$ 312	$ 117	$ 67	$ 0	$ 60	$ 0	$ 556
50%-59.99%	150	0	0	0	0	0	150
60%-69.99%	73	48	24	263	11	0	419
70%-79.99%	0	0	0	150	0	0	150
80%-89.99%	0	0	0	21	0	60	81
90%-100%	0	0	68	2	0	13	83
Greater than 100%	0	0	0	0	10	60	70
Total Hospitality	$ 535	$ 165	$ 159	$ 436	$ 81	$ 133	$ 1,509

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Commercial mortgage loans—Other

	Debt Service Coverage Ratio—September 30, 2012						
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X (in millions)	1.0X to <1.2X	Less than 1.0X	Total
Loan-to-Value Ratio							
0%-49.99%	$ 264	$ 0	$ 91	$ 23	$ 4	$ 0	$ 382
50%-59.99%	171	274	233	71	9	0	758
60%-69.99%	252	111	321	296	66	0	1,046
70%-79.99%	283	48	0	98	12	0	441
80%-89.99%	0	0	0	60	0	6	66
90%-100%	0	0	0	0	16	52	68
Greater than 100%	0	0	19	12	3	32	66
Total Other	$ 970	$ 433	$ 664	$ 560	$ 110	$ 90	$ 2,827

Commercial mortgage loans—Agricultural Properties

	Debt Service Coverage Ratio—September 30, 2012						
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X (in millions)	1.0X to <1.2X	Less than 1.0X	Total
Loan-to-Value Ratio							
0%-49.99%	$ 517	$ 184	$ 299	$ 406	$ 149	$ 2	$ 1,557
50%-59.99%	58	15	140	33	0	0	246
60%-69.99%	139	6	177	0	0	0	322
70%-79.99%	0	0	0	0	0	0	0
80%-89.99%	0	0	0	0	0	44	44
90%-100%	0	0	0	0	0	0	0
Greater than 100%	0	0	0	0	0	0	0
Total Agricultural	$ 714	$ 205	$ 616	$ 439	$ 149	$ 46	$ 2,169

Commercial mortgage and agricultural loans

Debt Service Coverage Ratio—September 30, 2012						
Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X	1.0X to <1.2X	Less than 1.0X	Total

				(in millions)			
Loan-to-Value Ratio							
0%-49.99%	$ 5,748	$ 1,830	$ 1,513	$ 1,269	$ 428	$ 89	$ 10,877
50%-59.99%	2,416	1,199	1,523	897	110	187	6,332
60%-69.99%	3,822	1,162	2,186	2,256	733	140	10,299
70%-79.99%	1,221	524	716	1,301	612	193	4,567
80%-89.99%	20	0	19	338	395	539	1,311
90%-100%	0	0	68	44	63	263	438
Greater than 100%	0	0	19	89	20	195	323
Total Commercial Mortgage and Agricultural	$ 13,227	$ 4,715	$ 6,044	$ 6,194	$ 2,361	$ 1,606	$ 34,147

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

The following tables set forth the credit quality indicators as of December 31, 2011, based upon the recorded investment gross of allowance for credit losses.

Commercial mortgage loans—Industrial

	Debt Service Coverage Ratio—December 31, 2011						
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X (in millions)	1.0X to <1.2X	Less than 1.0X	Total
Loan-to-Value Ratio							
0%-49.99%	$ 627	$ 311	$ 211	$ 254	$ 19	$ 48	$ 1,470
50%-59.99%	299	86	315	246	73	46	1,065
60%-69.99%	922	287	380	308	373	105	2,375
70%-79.99%	175	86	136	448	402	95	1,342
80%-89.99%	0	0	0	106	114	236	456
90%-100%	19	0	0	0	0	162	181
Greater than 100%	16	0	0	0	19	125	160
Total Industrial	$ 2,058	$ 770	$ 1,042	$ 1,362	$ 1,000	$ 817	$ 7,049

Commercial mortgage loans—Retail

	Debt Service Coverage Ratio—December 31, 2011						
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X (in millions)	1.0X to <1.2X	Less than 1.0X	Total
Loan-to-Value Ratio							
0%-49.99%	$ 1,188	$ 251	$ 523	$ 87	$ 18	$ 3	$ 2,070
50%-59.99%	627	507	590	54	48	3	1,829
60%-69.99%	351	539	739	485	82	17	2,213
70%-79.99%	0	47	289	608	18	0	962
80%-89.99%	0	31	0	9	17	23	80
90%-100%	0	0	18	14	16	40	88
Greater than 100%	0	0	0	21	46	0	67
Total Retail	$ 2,166	$ 1,375	$ 2,159	$ 1,278	$ 245	$ 86	$ 7,309

Commercial mortgage loans—Office

	Debt Service Coverage Ratio—December 31, 2011						
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X	1.0X to <1.2X	Less than 1.0X	Total
				(in millions)			
Loan-to-Value Ratio							
0%-49.99%	$ 1,756	$ 365	$ 181	$ 132	$ 23	$ 31	$ 2,488
50%-59.99%	572	106	210	198	16	9	1,111
60%-69.99%	612	412	79	460	61	38	1,662
70%-79.99%	65	0	31	15	618	15	744
80%-89.99%	0	0	0	138	52	54	244
90%-100%	0	0	16	0	0	18	34
Greater than 100%	0	0	17	71	8	12	108
Total Office	$ 3,005	$ 883	$ 534	$ 1,014	$ 778	$ 177	$ 6,391

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Commercial mortgage loans—Apartments/Multi-Family

	Debt Service Coverage Ratio—December 31, 2011						
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X (in millions)	1.0X to <1.2X	Less than 1.0X	Total
Loan-to-Value Ratio							
0%-49.99%	$ 726	$ 176	$ 272	$ 172	$ 215	$ 61	$ 1,622
50%-59.99%	95	16	257	156	59	31	614
60%-69.99%	425	18	341	356	76	88	1,304
70%-79.99%	107	99	146	729	130	47	1,258
80%-89.99%	0	15	0	107	0	52	174
90%-100%	0	0	13	16	2	77	108
Greater than 100%	0	0	0	36	21	140	197
Total Apartments/Multi-Family	$ 1,353	$ 324	$ 1,029	$ 1,572	$ 503	$ 496	$ 5,277

Commercial mortgage loans—Hospitality

	Debt Service Coverage Ratio—December 31, 2011						
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X (in millions)	1.0X to <1.2X	Less than 1.0X	Total
Loan-to-Value Ratio							
0%-49.99%	$ 143	$ 158	$ 0	$ 115	$ 22	$ 0	$ 438
50%-59.99%	51	0	0	9	57	0	117
60%-69.99%	0	6	45	350	11	0	412
70%-79.99%	6	0	0	0	117	61	184
80%-89.99%	0	0	77	49	37	36	199
90%-100%	0	0	19	0	21	15	55
Greater than 100%	0	0	0	0	2	79	81
Total Hospitality	$ 200	$ 164	$ 141	$ 523	$ 267	$ 191	$ 1,486

Commercial mortgage loans—Other

	Debt Service Coverage Ratio—December 31, 2011						
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X	1.0X to <1.2X	Less than 1.0X	Total

				(in millions)			
Loan-to-Value Ratio							
0%-49.99%	$ 333	$ 31	$ 6	$ 74	$ 1	$ 1	$ 446
50%-59.99%	50	185	20	7	0	0	262
60%-69.99%	111	173	280	295	118	7	984
70%-79.99%	286	0	202	286	13	0	787
80%-89.99%	0	0	61	21	15	5	102
90%-100%	0	19	0	0	16	15	50
Greater than 100%	0	0	0	0	2	74	76
Total Other	$ 780	$ 408	$ 569	$ 683	$ 165	$ 102	$ 2,707

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Commercial mortgage loans—Agricultural Properties

	Debt Service Coverage Ratio—December 31, 2011						
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X (in millions)	1.0X to <1.2X	Less than 1.0X	Total
Loan-to-Value Ratio							
0%-49.99%	$ 383	$ 123	$ 340	$ 427	$ 154	$ 0	$ 1,427
50%-59.99%	70	120	8	39	0	3	240
60%-69.99%	155	5	181	0	0	0	341
70%-79.99%	0	0	0	0	0	0	0
80%-89.99%	0	0	0	0	0	0	0
90%-100%	0	0	0	0	0	38	38
Greater than 100%	0	0	0	0	0	0	0
Total Agricultural	$ 608	$ 248	$ 529	$ 466	$ 154	$ 41	$ 2,046

Commercial mortgage and agricultural loans

	Debt Service Coverage Ratio—December 31, 2011						
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X (in millions)	1.0X to <1.2X	Less than 1.0X	Total
Loan-to-Value Ratio							
0%-49.99%	$ 5,156	$ 1,415	$ 1,533	$ 1,261	$ 452	$ 144	$ 9,961
50%-59.99%	1,764	1,020	1,400	709	253	92	5,238
60%-69.99%	2,576	1,440	2,045	2,254	721	255	9,291
70%-79.99%	639	232	804	2,086	1,298	218	5,277
80%-89.99%	0	46	138	430	235	406	1,255
90%-100%	19	19	66	30	55	365	554
Greater than 100%	16	0	17	128	98	430	689
Total Commercial Mortgage and Agricultural	$ 10,170	$ 4,172	$ 6,003	$ 6,898	$ 3,112	$ 1,910	$ 32,265

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

The following tables provide an aging of past due commercial mortgage and other loans as of the dates indicated, based upon the recorded investment gross of allowance for credit losses.

	As of September 30, 2012						
	Current	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days - Accruing (in millions)	Greater Than 90 Days - Not Accruing	Total Past Due	Total Commercial Mortgage and Other Loans
Commercial mortgage loans:							
Industrial	$ 7,493	$ 0	$ 0	$ 0	$ 0	$ 0	$ 7,493
Retail	8,176	1	0	0	5	6	8,182
Office	6,650	5	0	0	0	5	6,655
Apartments/Multi-Family	5,311	1	0	0	0	1	5,312
Hospitality	1,509	0	0	0	0	0	1,509
Other	2,817	4	0	0	6	10	2,827
Total commercial mortgage loans	31,956	11	0	0	11	22	31,978
Agricultural property loans	2,124	0	0	0	45	45	2,169
Residential property loans	867	12	5	0	17	34	901
Other collateralized loans	149	0	0	0	2	2	151
Uncollateralized loans	1,939	0	0	0	0	0	1,939
Total	$ 37,035	$ 23	$ 5	$ 0	$ 75	$ 103	$ 37,138

	As of December 31, 2011						
	Current	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days - Accruing (in millions)	Greater Than 90 Days - Not Accruing	Total Past Due	Total Commercial Mortgage and Other Loans
Commercial mortgage loans:							
Industrial	$ 7,047	$ 0	$ 2	$ 0	$ 0	$ 2	$ 7,049
Retail	7,294	0	0	0	15	15	7,309
Office	6,369	5	0	0	17	22	6,391
Apartments/Multi-Family	5,207	0	0	0	70	70	5,277
Hospitality	1,486	0	0	0	0	0	1,486
Other	2,657	13	10	0	27	50	2,707
Total commercial mortgage loans	30,060	18	12	0	129	159	30,219
Agricultural property loans	2,005	0	1	1	39	41	2,046

Residential property loans	988	22	6	0	18	46	1,034
Other collateralized loans	174	0	0	0	2	2	176
Uncollateralized loans	2,323	0	0	0	0	0	2,323
Total	$ 35,550	$ 40	$ 19	$ 1	$ 188	$ 248	$ 35,798

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Nonaccrual loans are those on which the accrual of interest has been suspended after the loans become 90 days delinquent as to principal or interest payments, or earlier when the Company has doubts about collectability and loans for which a loan specific reserve has been established. See Note 2 for further discussion regarding nonaccrual status loans. The following table sets forth commercial mortgage and other loans on nonaccrual status as of the dates indicated, based upon the recorded investment gross of allowance for credit losses:

	September 30, 2012	December 31, 2011
	(in millions)	
Commercial mortgage loans:		
Industrial	$ 42	$ 54
Retail	74	72
Office	2	58
Apartments/Multi-Family	41	129
Hospitality	72	169
Other	109	144
Total commercial mortgage loans	340	626
Agricultural property loans	50	44
Residential property loans	17	18
Other collateralized loans	18	15
Uncollateralized loans	8	8
Total	$ 433	$ 711

During the three months ended September 30, 2012, there were no commercial mortgage and other loans acquired, other than through direct origination, or sold, other than those classified as held for sale.

The following tables provide information about commercial mortgage and other loans involved in a troubled debt restructuring as of the dates indicated. The pre-modification outstanding recorded investment has been adjusted for any partial payoffs, and the table excludes troubled debt restructurings where we have received assets, other than loans, in full satisfaction of the loan. See Note 2 for additional information relating to the accounting for troubled debt restructurings.

	Three Months Ended September 30, 2012		Nine Months Ended September 30, 2012	
	Adjusted Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Adjusted Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
		(in millions)		
Commercial mortgage loans:				
Industrial	$ 0	$ 0	$ 0	$ 0

Retail	0	0	0	0
Office	0	0	5	5
Apartments/Multi-Family	0	0	0	0
Hospitality	0	0	0	0
Other	0	0	15	13
Total commercial mortgage loans	0	0	20	18
Agricultural property loans	0	0	0	0
Residential property loans	0	0	0	0
Other collateralized loans	0	0	0	0
Uncollateralized loans	0	0	0	0
Total	$ 0	$ 0	$ 20	$ 18

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

The amount of payment defaults during the period on commercial mortgage and other loans that were modified as a troubled debt restructuring within the last 12 months was less than $1 million as of September 30, 2012.

As of September 30, 2012, the Company committed to fund $6 million to borrowers that have been involved in a troubled debt restructuring.

Net Investment Income

Net investment income for the three and nine months ended September 30, 2012 and 2011 was from the following sources:

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(in millions)			
Fixed maturities, available-for-sale	$ 2,427	$ 2,401	$ 7,244	$ 6,958
Fixed maturities, held-to-maturity	34	37	102	105
Equity securities, available-for-sale	85	63	247	244
Trading account assets	215	249	666	668
Commercial mortgage and other loans	516	479	1,487	1,428
Policy loans	148	153	443	446
Broker-dealer related receivables	0	0	0	0
Short-term investments and cash equivalents	11	18	35	49
Other long-term investments	100	36	211	185
Gross investment income	3,536	3,436	10,435	10,083
Less: investment expenses	(103)	(103)	(324)	(305)
Net investment income	$ 3,433	$ 3,333	$ 10,111	$ 9,778

Realized Investment Gains (Losses), Net

Realized investment gains (losses), net, for the three and nine months ended September 30, 2012 and 2011, were from the following sources:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Fixed maturities	$ (53)	$ (2)	$ (148)	$ 2
Equity securities	40	(54)	3	126
Commercial mortgage and other loans	28	46	49	80
Investment real-estate	4	(4)	(63)	(16)
Joint ventures and limited partnerships	(3)	(19)	(1)	39
Derivatives(1)	(1,458)	2,557	(903)	2,693
Other	(3)	4	(3)	22
Realized investment gains (losses), net	$ (1,445)	$ 2,528	$ (1,066)	$ 2,946

(1) Includes the offset of hedged items in qualifying effective hedge relationships prior to maturity or termination.

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Net Unrealized Investment Gains (Losses)

Net unrealized investment gains and losses on securities classified as “available-for-sale” and certain other long-term investments and other assets are included in the Consolidated Statements of Financial Position as a component of “Accumulated other comprehensive income (loss),” or “AOCI.” Changes in these amounts include reclassification adjustments to exclude from “Other comprehensive income (loss)” those items that are included as part of “Net income” for a period that had been part of “Other comprehensive income (loss)” in earlier periods. The amounts for the periods indicated below, split between amounts related to fixed maturity securities on which an OTTI loss has been recognized, and all other net unrealized investment gains and losses, are as follows:

Net Unrealized Investment Gains and Losses on Fixed Maturity Securities on which an OTTI loss has been recognized

	Net Unrealized Gains (Losses) on Investments	Deferred Policy Acquisition Costs, Deferred Sales Inducements, and Value of Business Acquired	Future Policy Benefits	Policyholders’ Dividends	Deferred Income Tax (Liability) Benefit	Accumulated Other Comprehensive Income (Loss) Related To Net Unrealized Investment Gains (Losses)
				(in millions)		
Balance, December 31, 2011	$ (1,003)	$ 16	$ 14	$ 466	$ 269	$ (238)
Net investment gains (losses) on investments arising during the period	406				(142)	264
Reclassification adjustment for (gains) losses included in net income	244				(85)	159
Reclassification adjustment for OTTI losses excluded from net income(1)	(90)				32	(58)
Impact of net unrealized investment (gains) losses on deferred policy acquisition costs, deferred sales inducements and value of business acquired		(6)			2	(4)
Impact of net unrealized investment (gains) losses on future policy benefits			(6)		(2)	(8)
Impact of net unrealized investment (gains) losses on policyholders’ dividends				(232)	81	(151)
Balance, September 30, 2012	$ (443)	$ 10	$ 8	$ 234	$ 155	$ (36)

(1) Represents “transfers in” related to the portion of OTTI losses recognized during the period that were not recognized in earnings for securities with no prior OTTI loss.

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

All Other Net Unrealized Investment Gains and Losses in AOCI

	Net Unrealized Gains (Losses) on Investments(1)	Deferred Policy Acquisition Costs, Deferred Sales Inducements, and Value of Business Acquired	Future Policy Benefits	Policyholders’ Dividends	Deferred Income Tax (Liability) Benefit	Accumulated Other Comprehensive Income (Loss) Related To Net Unrealized Investment Gains (Losses)
			(in millions)			
Balance, December 31, 2011	$ 15,748	$ (1,182)	$ (1,269)	$ (4,319)	$ (2,935)	$ 6,043
Net investment gains (losses) on investments arising during the period	8,757				(3,030)	5,727
Reclassification adjustment for (gains) losses included in net income	(76)				27	(49)
Reclassification adjustment for OTTI losses excluded from net income(2)	90				(32)	58
Impact of net unrealized investment (gains) losses on deferred policy acquisition costs, deferred sales inducements and value of business acquired		(173)			62	(111)
Impact of net unrealized investment (gains) losses on future policy benefits			(1,327)		469	(858)
Impact of net unrealized investment (gains) losses on policyholders’ dividends				(1,509)	540	(969)
Balance, September 30, 2012	$ 24,519	$ (1,355)	$ (2,596)	$ (5,828)	$ (4,899)	$ 9,841

(1) Includes cash flow hedges. See Note 14 for information on cash flow hedges.
(2) Represents “transfers out” related to the portion of OTTI losses recognized during the period that were not recognized in earnings for securities with no prior OTTI loss.

The table below presents net unrealized gains (losses) on investments by asset class as of the dates indicated:

	September 30, 2012	December 31, 2011
	(in millions)	
Fixed maturity securities on which an OTTI loss has been recognized	$ (443)	$ (1,003)
Fixed maturity securities, available-for-sale—all other	23,349	15,227

Equity securities, available-for-sale	1,321	613
Derivatives designated as cash flow hedges(1)	(125)	(86)
Other investments(2)	(26)	(6)
Net unrealized gains (losses) on investments	$ 24,076	$ 14,745

(1) See Note 14 for more information on cash flow hedges.

(2) As of September 30, 2012, includes $80 million of net unrealized losses on held-to-maturity securities that were previously transferred from available-for-sale. Also includes net unrealized gains on certain joint ventures that are included in “Other assets.”

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Duration of Gross Unrealized Loss Positions for Fixed Maturities

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

	September 30, 2012					
	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	$ 443	$ 9	$ 55	$ 5	$ 498	$ 14
Obligations of U.S. states and their political subdivisions	88	1	5	1	93	2
Foreign government bonds	3,649	54	302	36	3,951	90
Corporate securities	9,072	210	9,708	1,519	18,780	1,729
Commercial mortgage-backed securities	530	8	308	31	838	39
Asset-backed securities	989	17	4,303	1,015	5,292	1,032
Residential mortgage-backed securities	101	3	315	41	416	44
Total	$ 14,872	$ 302	$ 14,996	$ 2,648	$ 29,868	$ 2,950

(1) Includes $561 million of fair value and $70 million of gross unrealized losses at September 30, 2012, on securities classified as held-to-maturity, a portion of which are not reflected in “Accumulated other comprehensive income (loss).”

	December 31, 2011					
	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	$ 870	$ 8	$ 130	$ 10	$ 1,000	$ 18
Obligations of U.S. states and their political subdivisions	7	0	46	2	53	2
Foreign government bonds	4,017	182	306	27	4,323	209
Corporate securities	21,419	1,144	9,691	1,969	31,110	3,113
Commercial mortgage-backed securities	917	61	362	47	1,279	108
Asset-backed securities	2,746	40	4,134	1,785	6,880	1,825
Residential mortgage-backed securities	422	19	378	60	800	79

Total	$ 30,398	$ 1,454	$ 15,047	$ 3,900	$ 45,445	$ 5,354

(1) Includes $706 million of fair value and $98 million of gross unrealized losses at December 31, 2011, on securities classified as held-to-maturity, a portion of which are not reflected in “Accumulated other comprehensive income (loss).”

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

The gross unrealized losses at September 30, 2012 and December 31, 2011, are composed of $2,036 million and $3,535 million, respectively, related to high or highest quality securities based on NAIC or equivalent rating and $914 million and $1,819 million, respectively, related to other than high or highest quality securities based on NAIC or equivalent rating. At September 30, 2012, $1,718 million of the gross unrealized losses represented declines in value of greater than 20%, $173 million of which had been in that position for less than six months, as compared to $3,478 million at December 31, 2011, that represented declines in value of greater than 20%, $871 million of which had been in that position for less than six months. At September 30, 2012, the $2,648 million of gross unrealized losses of twelve months or more were concentrated in asset-backed securities, and in the finance, utilities, and consumer non-cyclical sectors of the Company’s corporate securities. At December 31, 2011, the $3,900 million of gross unrealized losses of twelve months or more were concentrated in asset-backed securities, and in the manufacturing, finance, and public utilities sectors of the Company’s corporate securities. In accordance with its policy described in Note 2, the Company concluded that an adjustment to earnings for other-than-temporary impairments for these securities was not warranted at September 30, 2012 or December 31, 2011. These conclusions are based on a detailed analysis of the underlying credit and cash flows on each security. The gross unrealized losses are primarily attributable to foreign currency movements, credit spread widening and increased liquidity discounts. At September 30, 2012, the Company does not intend to sell the securities and it is not more likely than not that the Company will be required to sell the securities before the anticipated recovery of its remaining amortized cost basis.

Duration of Gross Unrealized Loss Positions for Equity Securities

The following table shows the fair value and gross unrealized losses aggregated by length of time that individual equity securities have been in a continuous unrealized loss position, as of the following dates:

	September 30, 2012					
	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)					
Equity securities, available-for-sale	$ 1,320	$ 139	$ 0	$ 0	$ 1,320	$ 139

	December 31, 2011					
	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)					
Equity securities, available-for-sale	$ 2,602	$ 448	$ 0	$ 0	$ 2,602	$ 448

At September 30, 2012, $63 million of the gross unrealized losses represented declines of greater than 20%, $58 million of which had been in that position for less than six months. At December 31, 2011, $236 million of the gross unrealized losses represented declines of greater than 20%, $225 million of which had been in that position for less than six months. In accordance with its policy described in Note 2, the Company concluded that an adjustment for other-than-temporary impairments for these equity securities was not warranted at September 30, 2012 or

December 31, 2011.

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

5. 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”). A VIE is an entity that either (1) has equity investors that lack certain essential characteristics of a controlling financial interest (including the ability to control activities of the entity, the obligation to absorb the entity’s expected losses and the right to receive the entity’s expected residual returns) or (2) lacks sufficient equity to finance its own activities without financial support provided by other entities, which in turn would be expected to absorb at least some of the expected losses of the VIE.

If the Company determines that it is the VIE’s “primary beneficiary,” it consolidates the VIE. There are currently two models for determining whether or not the Company is the “primary beneficiary” of a VIE. The first relates to those VIEs that have the characteristics of an investment company and for which certain other conditions are true. These conditions are that (1) the Company does not have the implicit or explicit obligation to fund losses of the VIE and (2) the VIE is not a securitization entity, asset-backed financing entity or an entity that was formerly considered a qualified special-purpose entity. In this model the Company is the primary beneficiary if it stands to absorb a majority of the VIE’s expected losses or to receive a majority of the VIE’s expected residual returns and would be required to consolidate the VIE.

For all other VIEs, the Company is the primary beneficiary if the Company has (1) the power to direct the activities of the VIE that most significantly impact the economic performance of the entity and (2) the obligation to absorb losses of the entity that could be potentially significant to the VIE or the right to receive benefits from the entity that could be potentially significant. If both conditions are present the Company would be required to consolidate the VIE.

Consolidated Variable Interest Entities for which the Company is the Investment Manager

The Company is the investment manager of certain asset-backed investment vehicles (commonly referred to as collateralized debt obligations, or “CDOs”) and certain other vehicles for which the Company earns fee income for investment management services, including certain investment structures which the Company’s asset management business invests with other co-investors in investment funds referred to as feeder funds. The Company sells or syndicates investments through these vehicles, principally as part of the strategic investing activity of the Company’s asset management businesses. Additionally, the Company may invest in debt or equity securities issued by these vehicles. CDOs raise capital by issuing debt securities, and use the proceeds to purchase investments, typically interest-bearing financial instruments. The Company analyzes these relationships to determine whether it has (1) the power to direct the activities of the VIE that most significantly impact the economic performance of the entity and (2) the obligation to absorb losses of the entity that could be potentially significant to the VIE or the right to receive benefits from the entity that could be potentially significant and thus is the primary beneficiary. This analysis includes a review of (1) the Company’s rights and responsibilities as investment manager, (2) fees received by the Company and (3) other interests (if any) held by the Company. The Company is not required to provide, and has not provided, material financial or other support to any VIE for which it is the investment manager.

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

The Company has determined that it is the primary beneficiary of certain VIEs for which it is the asset manager, including certain CDOs and other investment structures, as it meets both conditions listed above. The table below reflects the carrying amount and balance sheet caption in which the assets and liabilities of consolidated VIEs for which the Company is the investment manager are reported. The assets of these VIEs are restricted and must be used first to settle liabilities of the VIE. The creditors of these VIEs do not have recourse to the Company in excess of the assets contained within the VIE.

	September 30, 2012	December 31, 2011
	(in millions)	
Fixed maturities, available-for-sale	$ 86	$ 83
Other trading account assets	502	271
Commercial mortgage and other loans	139	154
Other long-term investments	23	19
Cash and cash equivalents	74	275
Accrued investment income	0	1
Other assets	30	17
Total assets of consolidated VIEs	$ 854	$ 820
Other liabilities	$ 660	$ 723
Total liabilities of consolidated VIEs	$ 660	$ 723

The Company also consolidates a VIE whose beneficial interests are wholly-owned by consolidated subsidiaries. This VIE is not included in the table above and the Company does not currently intend to sell these beneficial interests to third parties.

Other Consolidated Variable Interest Entities

The Company is the primary beneficiary of certain VIEs in which the Company has invested, as part of its investment activities. Included among these structured investments are structured investments issued by a VIE that manages yen-denominated investments coupled with cross-currency coupon swap agreements thereby creating synthetic dual currency investments. The Company’s involvement in the structuring of these investments combined with its economic interest indicates that the Company is the primary beneficiary. The Company has not provided material financial or other support that was not contractually required to these VIEs. The table below reflects the carrying amount and balance sheet caption in which the assets and liabilities of consolidated VIEs for which the Company is not the investment manager are reported. These liabilities primarily comprise obligations under debt instruments issued by the VIEs that are non-recourse to the Company. The creditors of each consolidated VIE have recourse only to the assets of that VIE.

	September 30, 2012	December 31, 2011
	(in millions)	
Fixed maturities, available-for-sale	$ 127	$ 129
Fixed maturities, held-to-maturity	1,177	1,191
Trading account assets supporting insurance liabilities	7	8
Other long-term investments	10	141
Accrued investment income	5	5
Total assets of consolidated VIEs	$ 1,326	$ 1,474
Other liabilities	$ 1	$ 0
Total liabilities of consolidated VIEs	$ 1	$ 0

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

In addition, not reflected in the table above, the Company has created a trust that is a VIE, to facilitate Prudential Insurance’s Funding Agreement Notes Issuance Program (“FANIP”). The trust issues medium-term notes secured by funding agreements issued to the trust by Prudential Insurance with the proceeds of such notes. The trust is the beneficiary of an indemnity agreement with the Company that provides that the Company is responsible for costs related to the notes issued with limited exception. As a result, the Company has determined that it is the primary beneficiary of the trust, which is therefore consolidated.

The funding agreements represent an intercompany transaction that is eliminated upon consolidation. However, in recognition of the security interest in such funding agreements, the trust’s medium-term note liability of $2,298 million and $3,197 million at September 30, 2012 and December 31, 2011, respectively, is classified within “Policyholders’ account balances.” Creditors of the trust have recourse to Prudential Insurance if the trust fails to make contractual payments on the medium-term notes. The Company has not provided material financial or other support that was not contractually required to the trust.

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, including certain CDOs and other investment structures, as it does not have both (1) the power to direct the activities of the VIE that most significantly impact the economic performance of the entity and (2) the obligation to absorb losses of the entity that could be potentially significant to the VIE or the right to receive benefits from the entity that could be potentially significant. 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 $521 million and $534 million at September 30, 2012 and December 31, 2011, respectively. These investments are reflected in “Fixed maturities, available-for-sale,” “Other trading account assets, at fair value” and “Other long-term investments.” The fair value of assets held within these unconsolidated VIEs was $8,056 million and $7,720 million as of September 30, 2012 and December 31, 2011, respectively. There are no liabilities associated with these unconsolidated VIEs on the Company’s balance sheet.

In the normal course of its activities, the Company will invest in joint ventures and limited partnerships. These ventures 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 has determined that it is not required to consolidate these entities because either (1) it does not control them or (2) it does not have the obligation to absorb losses of the entities that could be potentially significant to the entities or the right to receive benefits from the entities that could be potentially significant. The Company classifies these investments as “Other long-term investments” and its maximum exposure to loss associated with these entities was $4,690 million and $4,486 million as of September 30, 2012 and December 31, 2011, 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 4 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.

Included among these structured investments are asset-backed securities issued by VIEs that manage investments in the European market. In addition to a stated coupon, each investment provides a return based on the VIE’s portfolio of assets and related investment activity. The market value of these VIEs was approximately

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

$2.2 billion and $2.6 billion as of September 30, 2012 and December 31, 2011, respectively, and these VIEs were financed primarily through the issuance of notes similar to those purchased by the Company. The Company generally accounts for these investments as available-for-sale fixed maturities containing embedded derivatives that are bifurcated and marked-to-market through “Realized investment gains (losses), net,” based upon the change in value of the underlying portfolio. The Company’s variable interest in each of these VIEs represents less than 50% of the only class of variable interests issued by the VIE. The Company’s maximum exposure to loss from these interests was $312 million and $664 million at September 30, 2012 and December 31, 2011, respectively, which includes the fair value of the embedded derivatives.

6. CLOSED BLOCK

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

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

The excess of Closed Block Liabilities over Closed Block Assets at the date of the demutualization (adjusted to eliminate the impact of related amounts in “Accumulated other comprehensive income (loss)”) represented the estimated maximum future earnings at that date from the Closed Block expected to result from operations attributed to the Closed Block after income taxes. In establishing the Closed Block, the Company developed an actuarial calculation of the timing of such maximum future earnings. If actual cumulative earnings of the Closed Block from inception through the end of any given period are greater than the expected cumulative earnings, only the expected earnings will be recognized in income. Any excess of actual cumulative earnings over expected cumulative earnings will represent undistributed accumulated earnings attributable to policyholders, which are recorded as a policyholder dividend obligation. The policyholder dividend obligation represents amounts to be paid to Closed Block policyholders as an additional policyholder dividend unless otherwise offset by future Closed Block performance that is less favorable than originally expected. If the actual cumulative earnings of the Closed Block from its inception through the end of any given period are less than the expected cumulative earnings of the Closed Block, the Company will recognize only the actual earnings in income. However, the Company may reduce policyholder dividend scales, which would be intended to increase future actual earnings until the actual cumulative earnings equaled the expected cumulative earnings.

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

As of September 30, 2012 and December 31, 2011, the Company recognized a policyholder dividend obligation of $781 million and $762 million, respectively, to Closed Block policyholders for the excess of actual cumulative earnings over the expected cumulative earnings. Additionally, accumulated net unrealized investment gains that have arisen subsequent to the establishment of the Closed Block were reflected as a policyholder dividend obligation of $5,582 million and $3,847 million at September 30, 2012 and December 31, 2011, respectively, to be paid to Closed Block policyholders unless offset by future experience, with an offsetting amount reported in “Accumulated other comprehensive income (loss).” See the table below for changes in the components of the policyholder dividend obligation for the nine months ended September 30, 2012.

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

	September 30, 2012	December 31, 2011
	(in millions)	
Closed Block Liabilities		
Future policy benefits	$ 50,953	$ 51,423
Policyholders’ dividends payable	947	902
Policyholders’ dividend obligation	6,363	4,609
Policyholders’ account balances	5,442	5,484
Other Closed Block liabilities	4,648	4,031
Total Closed Block Liabilities	68,353	66,449
Closed Block Assets		
Fixed maturities, available-for-sale, at fair value	42,782	42,024
Other trading account assets, at fair value	214	269
Equity securities, available-for-sale, at fair value	3,171	3,122
Commercial mortgage and other loans	8,914	8,322
Policy loans	5,150	5,296
Other long-term investments	2,116	2,080
Short-term investments	1,390	485
Total investments	63,737	61,598
Cash and cash equivalents	739	1,006
Accrued investment income	590	571
Other Closed Block assets	305	284
Total Closed Block Assets	65,371	63,459
Excess of reported Closed Block Liabilities over Closed Block Assets	2,982	2,990
Portion of above representing accumulated other comprehensive income:		
Net unrealized investment gains (losses)	5,568	3,836
Allocated to policyholder dividend obligation	(5,582)	(3,847)

Future earnings to be recognized from Closed Block Assets and Closed Block Liabilities	$ 2,968	$ 2,979

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Information regarding the policyholder dividend obligation is as follows:

	Nine Months Ended September 30, 2012 (in millions)
Balance, January 1	$ 4,609
Impact from earnings allocable to policyholder dividend obligation	19
Change in net unrealized investment gains (losses) allocated to policyholder dividend obligation	1,735
Balance, September 30	$ 6,363

Closed Block revenues and benefits and expenses for the three and nine months ended September 30, 2012 and 2011 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Revenues				
Premiums	$ 646	$ 666	$ 2,060	$ 2,129
Net investment income	710	731	2,177	2,221
Realized investment gains (losses), net	74	243	220	495
Other income	15	(2)	14	30
Total Closed Block revenues	1,445	1,638	4,471	4,875
Benefits and Expenses				
Policyholders’ benefits	776	827	2,565	2,557
Interest credited to policyholders’ account balances	34	35	103	104
Dividends to policyholders	478	639	1,454	1,848
General and administrative expenses	122	129	372	392
Total Closed Block benefits and expenses	1,410	1,630	4,494	4,901
Closed Block revenues, net of Closed Block benefits and expenses, before income taxes and discontinued operations	35	8	(23)	(26)
Income tax benefit	29	5	(36)	(32)
Closed Block revenues, net of Closed Block benefits and expenses and income taxes, before discontinued operations	6	3	13	6
Income (loss) from discontinued operations, net of taxes	(1)	0	(2)	0

Closed Block revenues, net of Closed Block benefits and expenses, income taxes and discontinued operations	$ 5	$ 3	$ 11	$ 6

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

7. EQUITY

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

	Common Stock			Class B Stock
	Issued	Held In Treasury	Outstanding	Issued and Outstanding
	(in millions)			
Balance, December 31, 2011	660.1	192.1	468.0	2.0
Common Stock issued	0.0	0.0	0.0	0.0
Common Stock acquired	0.0	11.5	(11.5)	0.0
Stock-based compensation programs(1)	0.0	(5.5)	5.5	0.0
Balance, September 30, 2012	660.1	198.1	462.0	2.0

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

In June 2011, Prudential Financial’s Board of Directors authorized the Company to repurchase at management’s discretion up to $1.5 billion of its outstanding Common Stock through June 2012. Under this authorization, 28.6 million shares of the Company’s Common Stock were repurchased at a total cost of $1.5 billion, of which 8.8 million shares were repurchased in the first six months of 2012 at a total cost of $500 million.

In June 2012, Prudential Financial’s Board of Directors authorized the Company to repurchase at management’s discretion up to $1.0 billion of its outstanding Common Stock through June 2013. As of September 30, 2012, 2.7 million shares of the Company’s Common Stock were repurchased under this authorization at a total cost of $150 million.

The balance of and changes in each component of “Accumulated other comprehensive income (loss) attributable to Prudential Financial, Inc.” for the nine months ended September 30, 2012 and 2011 are as follows (net of taxes):

	Accumulated Other Comprehensive Income (Loss) Attributable to Prudential Financial, Inc.			
	Foreign Currency Translation Adjustment	Net Unrealized Investment Gains	Pension and Postretirement Unrecognized Net	Total Accumulated Other

		(Losses)(1)	Periodic Benefit (Cost)	Comprehensive Income (Loss)
			(in millions)	
Balance, December 31, 2011	$ 1,107	$ 5,805	$ (1,494)	$ 5,418
Change in component during period	134	4,000	98	4,232
Balance, September 30, 2012	$ 1,241	$ 9,805	$ (1,396)	$ 9,650

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Accumulated Other Comprehensive Income (Loss) Attributable to Prudential Financial, Inc.			
	Foreign Currency Translation Adjustment	Net Unrealized Investment Gains (Losses)(1)	Pension and Postretirement Unrecognized Net Periodic Benefit (Cost)	Total Accumulated Other Comprehensive Income (Loss)
	(in millions)			
Balance, December 31, 2010	$ 1,145	$ 3,145	$ (1,312)	$ 2,978
Cumulative effect of accounting adoption	(279)	100	—	(179)
Change in component during period	283	2,023	34	2,340
Balance, September 30, 2011	$ 1,149	$ 5,268	$ (1,278)	$ 5,139

(1) Includes cash flow hedges of $(81) million and $(55) million as of September 30, 2012 and December 31, 2011, respectively, and $(66) million and $(169) million as of September 30, 2011 and December 31, 2010, respectively. See Note 4 for additional information regarding unrealized investment gains (losses), including the split between amounts related to fixed maturity securities on which an other-than-temporary impairment loss has been recognized, and all other unrealized investment gains (losses).

8. EARNINGS PER SHARE

The Company has outstanding two separate classes of common stock. The Common Stock reflects the performance of the Financial Services Businesses and the Class B Stock reflects the performance of the Closed Block Business. Accordingly, earnings per share is calculated separately for each of these two classes of common stock.

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

The direct equity adjustments modify the earnings available to each of the classes of common stock for earnings per share purposes.

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Common Stock

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

	Three Months Ended September 30,					
	2012			2011		
	Income	Weighted Average Shares	Per Share Amount	Income	Weighted Average Shares	Per Share Amount
	(in millions, except per share amounts)					
Basic earnings per share						
Income (loss) from continuing operations attributable to the Financial Services Businesses	$ (635)			$ 1,581		
Direct equity adjustment	4			8		
Less: Income attributable to noncontrolling interests	25			10		
Less: Earnings allocated to participating unvested share-based payment awards	0			21		
Income (loss) from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment	$ (656)	464.4	$ (1.41)	$ 1,558	481.2	$ 3.24
Effect of dilutive securities and compensation programs(1)						
Add: Earnings allocated to participating unvested share-based payment awards—Basic	$ 0			$ 21		
Less: Earnings allocated to participating unvested share-based payment awards—Diluted	0			20		
Stock options		0.0			2.5	
Deferred and long-term compensation programs		0.0			0.5	
Exchangeable Surplus Notes	0	0.0		4	5.1	
Diluted earnings per share(1)						
Income (loss) from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment	$ (656)	464.4	$ (1.41)	$ 1,563	489.3	$ 3.19

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Nine Months Ended September 30, 2012 Income	2012 Weighted Average Shares	2012 Per Share Amount	2011 Income	2011 Weighted Average Shares	2011 Per Share Amount
	(in millions, except per share amounts)					
Basic earnings per share						
Income from continuing operations attributable to the Financial Services Businesses	$ 591			$ 2,923		
Direct equity adjustment	20			25		
Less: Income attributable to noncontrolling interests	51			64		
Less: Earnings allocated to participating unvested share-based payment awards	6			39		
Income from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment	$ 554	466.6	$ 1.19	$ 2,845	484.0	$ 5.88
Effect of dilutive securities and compensation programs(2)						
Add: Earnings allocated to participating unvested share-based payment awards—Basic	$ 6			$ 39		
Less: Earnings allocated to participating unvested share-based payment awards—Diluted	6			38		
Stock options		2.1			3.1	
Deferred and long-term compensation programs		0.5			0.5	
Exchangeable Surplus Notes	0	0.0		13	5.1	
Diluted earnings per share(2)						
Income from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment	$ 554	469.2	$ 1.18	$ 2,859	492.7	$ 5.80

(1) For the three months ended September 30, 2012, weighted average shares for basic earnings per share is also used for calculating diluted earnings per share because dilutive shares and dilutive earnings per share are not applicable when a loss from continuing operations is reported. As a result of the loss from continuing operations available to holders of Common Stock after direct equity adjustment for the three months ended September 30, 2012, all potential stock options and compensation programs were considered antidilutive.

(2) For the nine months ended September 30, 2012, weighted average shares used for calculating diluted earnings per share excludes the potential shares that would be issued related to the exchangeable surplus notes since the hypothetical impact of these shares was antidilutive. In calculating diluted earnings per share under the if-converted method, the potential shares that would be issued related to the exchangeable surplus notes assuming a hypothetical exchange, weighted for the period the notes are outstanding, is added to the denominator, and interest expense, net of tax, is added to the numerator, if the overall effect is dilutive.

Unvested share-based payment awards that contain nonforfeitable rights to dividends are participating securities and included in the computation of earnings per share pursuant to the two-class method. Under this method, earnings of the Financial Services Businesses attributable to Prudential Financial, Inc. are allocated between Common Stock and the participating awards, as if the awards were a second class of stock. For the three months ended September 30, 2012, undistributed earnings were not allocated to participating unvested share-based payment awards as these awards do not participate in losses. Undistributed earnings allocated to participating unvested share-based payment awards for the three months ended September 30, 2011 were based on 6.3 million of such awards weighted for the period they were outstanding. Undistributed earnings allocated to

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

participating unvested share-based payment awards for the nine months ended September 30, 2012 and 2011 were based on 4.7 million and 6.6 million of such awards, respectively, weighted for the period they were outstanding. The computation of earnings per share of Common Stock excludes the dilutive impact of participating unvested share-based awards based on the application of the two-class method.

For the three months ended September 30, 2012, 20.1 million options and 5.1 million shares related to deferred and long-term compensation programs, weighted for the portion of the period they were outstanding, are considered antidilutive as a result of the loss from continuing operations available to holders of Common Stock after direct equity adjustment. For the three months ended September 30, 2011, 12.1 million options, weighted for the portion of the period they were outstanding, with a weighted average exercise price of $71.15 per share, were excluded from the computation of diluted earnings per share because the options, based on application of the treasury stock method, were antidilutive. For the nine months ended September 30, 2012 and 2011, 13.1 million and 10.3 million options, respectively, weighted for the portion of the period they were outstanding, with a weighted average exercise price of $70.11 and $73.75 per share, respectively, were excluded from the computation of diluted earnings per share because the options, based on application of the treasury stock method, were antidilutive.

In September 2009, the Company issued $500 million of surplus notes with an interest rate of 5.36% per annum which are exchangeable at the option of the note holders for shares of Common Stock. The exchange rate used in the diluted earnings per share calculation for the surplus notes is 10.1235 shares of Common Stock per each $1,000 principal amount of surplus notes. In calculating diluted earnings per share under the if-converted method, the potential shares that would be issued assuming a hypothetical exchange, weighted for the period the notes are outstanding, are added to the denominator, and interest expense, net of tax, is added to the numerator, if the overall effect is dilutive.

Class B Stock

Income from continuing operations per share of Class B Stock for the three and nine months ended September 30 are presented below. There are no potentially dilutive shares associated with the Class B Stock.

	Three Months Ended September 30,					
	2012			2011		
	Income	Weighted Average Shares	Per Share Amount	Income	Weighted Average Shares	Per Share Amount
	(in millions, except per share amounts)					
Basic earnings per share						
Income from continuing operations attributable to the Closed Block Business	$ 44			$ 32		
Less: Direct equity adjustment	4			8		
Income from continuing operations attributable to the Closed Block Business available to holders of Class B Stock after direct equity adjustment	$ 40	2.0	$ 20.00	$ 24	2.0	$ 12.00

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Nine Months Ended September 30,					
	2012			2011		
	Income	Weighted Average Shares	Per Share Amount	Income	Weighted Average Shares	Per Share Amount
	(in millions, except per share amounts)					
Basic earnings per share						
Income from continuing operations attributable to the Closed Block Business	$ 61			$ 64		
Less: Direct equity adjustment	20			25		
Income from continuing operations attributable to the Closed Block Business available to holders of Class B Stock after direct equity adjustment	$ 41	2.0	$ 20.50	$ 39	2.0	$ 19.50

9. SHORT-TERM AND LONG-TERM DEBT

Commercial Paper

The Company issues commercial paper under the two programs described below. At September 30, 2012 and December 31, 2011, the weighted average maturity of total commercial paper outstanding was 17 and 21 days, respectively.

Prudential Financial has a commercial paper program with an authorized capacity of $3.0 billion. Prudential Financial commercial paper borrowings generally have been used to fund the working capital needs of Prudential Financial’s subsidiaries and provide short-term liquidity at Prudential Financial.

Prudential Funding, LLC, a wholly-owned subsidiary of Prudential Insurance, has a commercial paper program with an authorized capacity of $7.0 billion. Prudential Funding commercial paper borrowings generally have served as an additional source of financing to meet the working capital needs of Prudential Insurance and its subsidiaries. Prudential Funding also lends to other subsidiaries of Prudential Financial up to limits agreed with the New Jersey Department of Banking and Insurance. Prudential Funding maintains a support agreement with Prudential Insurance whereby Prudential Insurance has agreed to maintain Prudential Funding’s positive tangible net worth at all times. Prudential Financial has issued a subordinated guarantee covering Prudential Funding’s commercial paper program.

The table below presents the Company’s total outstanding commercial paper borrowings as of the dates indicated:

	September 30, 2012	December 31, 2011
	(in millions)	
Prudential Financial	$ 264	$ 296
Prudential Funding, LLC	700	870
Total outstanding commercial paper borrowings	$ 964	$ 1,166

Federal Home Loan Bank of New York

Prudential Insurance is a member of the Federal Home Loan Bank of New York, or FHLBNY. Membership allows Prudential Insurance access to the FHLBNY’s financial services, including the ability to obtain collateralized loans and to issue collateralized funding agreements that can be used as an alternative source of

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

liquidity. FHLBNY borrowings and funding agreements are collateralized by qualifying mortgage-related assets or U.S. Treasury securities, the fair value of which must be maintained at certain specified levels relative to outstanding borrowings, depending on the type of asset pledged. FHLBNY membership requires Prudential Insurance to own member stock and borrowings require the purchase of activity-based stock in an amount equal to 4.5% of outstanding borrowings. Under FHLBNY guidelines, if Prudential Insurance’s financial strength ratings decline below A/A2/A Stable by S&P/Moody’s/Fitch, respectively, and the FHLBNY does not receive written assurances from the New Jersey Department of Banking and Insurance, or NJDOBI, regarding Prudential Insurance’s solvency, new borrowings from the FHLBNY would be limited to a term of 90 days or less. Currently, there are no restrictions on the term of borrowings from the FHLBNY.

NJDOBI permits Prudential Insurance to pledge collateral to the FHLBNY in an amount of up to 5% of its prior year-end statutory net admitted assets, excluding separate account assets. Based on Prudential Insurance’s statutory net admitted assets as of December 31, 2011, the 5% limitation equates to a maximum amount of pledged assets of $7.7 billion and an estimated maximum borrowing capacity (after taking into account required collateralization levels and purchases of activity-based stock) of approximately $6.3 billion. Nevertheless, FHLBNY borrowings are subject to the FHLBNY’s discretion and to the availability of qualifying assets at Prudential Insurance.

As of September 30, 2012, Prudential Insurance had pledged qualifying assets with a fair value of $2.9 billion, which supported outstanding collateralized advances of $924 million and collateralized funding agreements of $1.5 billion with maturities ranging from 2013 to 2018.

As of September 30, 2012, $199 million of the FHLBNY outstanding advances is reflected in “Short-term debt” and matures in December 2012 and the remaining $725 million is in “Long-term debt” and matures in December 2015. The funding agreements issued to the FHLBNY, which are reflected in “Policyholders’ account balances,” have priority claim status above debt holders of Prudential Insurance. The fair value of qualifying assets that were available to Prudential Insurance but not pledged amounted to $2.9 billion as of September 30, 2012.

Federal Home Loan Bank of Boston

Prudential Retirement Insurance and Annuity Company, or PRIAC, is member of the Federal Home Loan Bank of Boston, or FHLBB. Membership allows PRIAC access to collateralized advances which will be classified in “Short-term debt” or “Long-term debt,” depending on the maturity date of the obligation. PRIAC’s membership in FHLBB requires the ownership of member stock and borrowings from FHLBB require the purchase of activity-based stock in an amount between 3.0% and 4.5% of outstanding borrowings depending on the maturity date of the obligation. As of September 30, 2012, PRIAC had no advances outstanding under the FHLBB facility.

The Connecticut Department of Insurance, or CTDOI, permits PRIAC to pledge up to $2.6 billion in qualifying assets to secure FHLBB borrowings through December 31, 2013. PRIAC must seek re-approval from CTDOI prior to borrowing additional funds after that date. Based on available eligible assets as of September 30, 2012, PRIAC had an estimated maximum borrowing capacity, after taking into consideration required collateralization levels and required purchases of activity-based FHLBB stock, of approximately $1.6 billion.

Credit Facilities

As of September 30, 2012, Prudential Financial and Prudential Funding maintained an aggregate of $3,750 million of unsecured committed credit facilities, which includes a $2,000 million five-year credit facility on which Prudential Financial is the sole borrower. These facilities have remaining terms ranging from 2.25 years to

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

4.25 years. There were no outstanding borrowings under these credit facilities as of September 30, 2012 or as of the date of this filing. Each of the facilities is available to the applicable borrowers up to the aggregate committed credit and may be used for general corporate purposes, including as backup liquidity for the Company’s commercial paper programs discussed above. Prudential Financial expects that it may borrow under the five-year credit facility from time to time to fund its working capital needs and those of its subsidiaries. In addition, up to $300 million of the five-year facility may be drawn in the form of standby letters of credit that can be used to meet the Company’s operating needs.

The credit facilities contain representations and warranties, covenants and events of default that are customary for facilities of this type; however, borrowings under the facilities are not contingent on our credit ratings nor subject to material adverse change clauses. Borrowings are conditioned on the continued satisfaction of customary conditions, including the maintenance at all times of consolidated net worth, relating to the Company’s Financial Services Businesses only, of at least $18.985 billion, which for this purpose is calculated as U.S. GAAP equity, excluding “Accumulated other comprehensive income (loss)” and excluding equity of noncontrolling interests. As of September 30, 2012 and December 31, 2011, the consolidated net worth of the Company’s Financial Services Businesses exceeded the minimum amount required to borrow under the credit facilities.

Sale of Asset-Backed Notes

On March 30, 2012, Prudential Insurance sold, in a Rule 144A private placement, $1.0 billion aggregate principal amount of 2.997% notes with a final maturity of September 30, 2015. The notes are secured by the assets of a trust, consisting of approximately $2.8 billion aggregate principal balance of residential mortgage-backed securities deposited into the trust by Prudential Insurance. Payments of interest and principal on the notes will be made only to the extent of funds available to the trust in accordance with a priority of payments set forth in the indenture governing the notes. Prudential Financial guaranteed to the holders of the notes the timely payment of all principal and interest due on the notes and any “make-whole payments” that may become due as a result of the payment of principal on the notes prior to its scheduled payment date.

Termination of Existing Replacement Capital Covenants and Execution of New Replacement Capital Covenant

On April 11, 2012, the Company terminated the replacement capital covenants that were entered into in 2008 in connection with its issuance of $600 million of 8.875% fixed-to-floating rate junior subordinated notes (the “8.875% junior subordinated notes”) and $920 million of 9.0% junior subordinated notes. The Company received the consent of holders of a majority in principal amount of its 6.625% medium-term notes due 2037, as was required for the termination of the replacement capital covenants. The Company also entered into a new replacement capital covenant with respect to the 8.875% junior subordinated notes only. The new replacement capital covenant was entered into for the benefit of the holders of the Company’s 5.90% medium-term notes due March 2036 and requires that the Company not repay, redeem or purchase the 8.875% junior subordinated notes prior to June 15, 2038 unless it has received proceeds from the sale or issuance of common stock or other qualifying securities that have certain characteristics that are at least as equity-like as the 8.875% junior subordinated notes. However, the terms of the new replacement capital covenant will not apply in certain instances, including (i) if Standard & Poor’s upgrades the Company’s corporate credit rating by at least one notch above “A+” or (ii) if the Company repurchases or redeems up to 10% of the outstanding principal amount of the 8.875% junior subordinated notes in any one-year period, provided that no more than 25% of the outstanding principal amount of the 8.875% junior subordinated notes are repurchased or redeemed in any ten-year period.

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Surplus Notes

During 2011, a captive reinsurance subsidiary entered into agreements providing for the issuance and sale of up to $1 billion of ten-year fixed-rate surplus notes. In June 2012, this subsidiary entered into another agreement for the issuance of up to an additional $500 million of ten-year fixed rate surplus notes. At September 30, 2012, $750 million of surplus notes were outstanding under this facility. Under the agreements, the subsidiary received debt securities, with a principal amount equal to the surplus notes issued, which are redeemable under certain circumstances, including upon the occurrence of specified stress events affecting the subsidiary. Because valid rights of set-off exist, interest and principal payments on the surplus notes and on the debt securities are settled on a net basis, and the surplus notes are reflected in the Company’s total consolidated borrowings on a net basis. Prudential Financial agreed that it or one of its affiliates will make capital contributions to the subsidiary in order to reimburse it for any investment losses in excess of specified amounts. Surplus notes issued under this facility are subordinated to policyholder obligations, and the payment of principal on the surplus notes may only be made with prior insurance regulatory approval. The payment of interest on the surplus notes has been approved by the regulator, subject to the ability of the regulator to withdraw that approval.

Medium-term Notes

Prudential Financial maintains a Medium-term Notes, Series D program under its shelf registration statement with an authorized issuance capacity of $20 billion. As of September 30, 2012, the outstanding balance of Medium-term notes was $13.2 billion, a decrease of $0.9 billion from December 31, 2011, driven by $850 million of maturities.

Retail Medium-term Notes

Prudential Financial maintains a retail medium-term notes program, including the InterNotes® program, under its shelf registration statement with an authorized issuance capacity of $5.0 billion. As of September 30, 2012, the outstanding balance of retail notes was $1.6 billion. In the third quarter of 2012, the Company redeemed $959 million of its outstanding retail notes with an average interest rate of approximately 6%.

Junior Subordinated Notes

On August 9, 2012, Prudential Financial issued $1.0 billion of 5.875% fixed-to-floating rate junior subordinated notes in a public offering. The notes are considered hybrid capital securities that receive enhanced equity treatment from the rating agencies. The notes have a maturity date of September 15, 2042. Interest is payable semi-annually at a fixed rate of 5.875% until September 15, 2022, from which date interest is payable quarterly at a floating rate of 3-month LIBOR plus 4.175%. Prudential Financial has the right to defer interest payments on the notes for a period of up to five years, during which time interest will be compounded. At the end of five years following the commencement of a deferral period, Prudential Financial must pay all accrued and unpaid deferred interest, including compounded interest. If all deferred interest (including compounded interest thereon) on the notes has been paid, Prudential Financial can again defer interest payments on the notes. Prudential Financial may redeem the notes, in whole but not in part, at any time prior to September 15, 2022, within 90 days after the occurrence of a “tax event”, a “rating agency event” or a “regulatory capital event” at a redemption price equal to (i) in the case of a “tax event” or a “rating agency event”, their principal amount or, if greater, a make-whole redemption price plus accrued and unpaid interest or (ii) in the case of a “regulatory capital event”, their principal amount plus accrued and unpaid interest. On or after September 15, 2022, Prudential Financial may redeem the notes, in whole or in part, at their principal amount plus accrued and unpaid interest.

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

10. EMPLOYEE BENEFIT PLANS

Pension and Other Postretirement Plans

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

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

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

	Three Months Ended September 30,			
	Pension Benefits		Other Postretirement Benefits	
	2012	2011	2012	2011
	(in millions)			
Components of net periodic (benefit) cost				
Service cost	$ 61	$ 58	$ 4	$ 3
Interest cost	117	123	25	27
Expected return on plan assets	(181)	(180)	(22)	(24)
Amortization of prior service cost	4	6	(3)	(3)
Amortization of actuarial (gain) loss, net	27	10	14	9
Special termination benefits	5	1	0	0
Net periodic (benefit) cost	$ 33	$ 18	$ 18	$ 12

	Nine Months Ended September 30,			
	Pension Benefits		Other Postretirement Benefits	
	2012	2011	2012	2011
	(in millions)			
Service cost	$ 182	$ 163	$ 11	$ 9

Interest cost	355	365	76	81
Expected return on plan assets	(543)	(539)	(66)	(72)
Amortization of prior service cost	10	18	(9)	(9)
Amortization of actuarial (gain) loss, net	80	30	41	27
Special termination benefits	7	3	0	0
Net periodic (benefit) cost	$ 91	$ 40	$ 53	$ 36

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

11. SEGMENT INFORMATION

Segments

The Company has organized its principal operations into the Financial Services Businesses and the Closed Block Business. Within the Financial Services Businesses, the Company operates through three divisions, which together encompass six reportable segments. Businesses that are not sufficiently material to warrant separate disclosure and divested businesses are included in Corporate and Other operations within the Financial Services Businesses. Collectively, the businesses that comprise the three operating divisions and Corporate and Other are referred to as the Financial Services Businesses.

Adjusted Operating Income

In managing the Financial Services Businesses, the Company analyzes the operating performance of each segment using “adjusted operating income.” Adjusted operating income does not equate to “income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures” or “net income” as determined in accordance with U.S. GAAP but is the measure of segment profit or loss used by the Company to evaluate segment performance and allocate resources, and consistent with authoritative guidance, is the measure of segment performance presented below. Adjusted operating income is calculated by adjusting each segment’s “income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures” for the following items, which are described in greater detail below:

• realized investment gains (losses), net, and related charges and adjustments;

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

• the contribution to income/loss of divested businesses that have been or will be sold or exited, including businesses that have been placed in wind down status, but that did not qualify for “discontinued operations” accounting treatment under U.S. GAAP; and

• equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests.

These items are important to an understanding of overall results of operations. Adjusted operating income is not a substitute for income determined in accordance with U.S. GAAP, and the Company’s definition of adjusted operating income may differ from that used by other companies. However, the Company believes that the presentation of adjusted operating income as measured for management purposes enhances the understanding of results of operations by highlighting the results from ongoing operations and the underlying profitability factors of the Financial Services Businesses.

As described in Note 1, during the second quarter of 2012, the Company recorded two out of period adjustments that resulted in a decrease of $122 million to “Income from continuing operations before income taxes and equity in earnings of operating joint ventures.” The adjustments resulted in a decrease in adjusted operating income of $106 million for the nine months ended September 30, 2012, including a reduction of $61 million to the Asset Management segment and a reduction of $45 million to the Corporate and Other operations of the Financial Services Businesses resulting from the increase in reserves. In addition, the reserves adjustment resulted in a reduction of $16 million to the Closed Block Business which was excluded from adjusted operating income.

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Realized investment gains (losses), net, and related charges and adjustments

Realized investment gains (losses), net

Adjusted operating income excludes “Realized investment gains (losses), net,” except for certain items described below. Significant activity excluded from adjusted operating income includes impairments and credit-related gains and losses from sales of securities, the timing of which depends largely on market credit cycles and can vary considerably across periods, and interest rate-related gains and losses from sales of securities, which are largely subject to the Company’s discretion and influenced by market opportunities, as well as the Company’s tax and capital profile. Additionally, certain gains and losses pertaining to derivative contracts that do not qualify for hedge accounting treatment are also excluded from adjusted operating income. Trends in the underlying profitability of the Company’s businesses can be more clearly identified without the fluctuating effects of these transactions.

The following table sets forth the components of “Realized investment gains (losses), net” that are included in adjusted operating income and, as a result, are reflected as adjustments to “Realized investment gains (losses), net” for purposes of calculating adjusted operating income:

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(in millions)			
Net gains (losses) from:				
Terminated hedges of foreign currency earnings	$ (20)	$ (41)	$ (68)	$ (105)
Current period yield adjustments	$ 88	$ 66	$ 242	$ 189
Principal source of earnings	$ 33	$ 41	$ 14	$ 144

Terminated Hedges of Foreign Currency Earnings. The amounts shown in the table above primarily reflect the impact of an intercompany arrangement between Corporate and Other operations and the International Insurance segment, pursuant to which the non-U.S. dollar-denominated earnings in all countries for a particular year, including its interim reporting periods, are translated at fixed currency exchange rates. The fixed rates are determined in connection with a currency hedging program designed to mitigate the risk that unfavorable rate changes will reduce the segment’s U.S. dollar equivalent earnings. Pursuant to this program, the Company’s Corporate and Other operations may execute forward currency contracts with third parties to sell the net exposure of projected earnings from the hedged currency in exchange for U.S. dollars at a specified exchange rate. The maturities of these contracts correspond with the future periods in which the identified non-U.S. dollar-denominated earnings are expected to be generated. These contracts do not qualify for hedge accounting under U.S. GAAP, so the resulting profits or losses are recorded in “Realized investment gains (losses), net.” When the contracts are terminated in the same period that the expected earnings emerge, the resulting positive or negative cash flow effect is included in adjusted operating income.

Current Period Yield Adjustments. The Company uses interest rate and currency swaps and other derivatives to manage interest and currency exchange rate exposures arising from mismatches between assets and liabilities, including duration mismatches. For derivative contracts that do not qualify for hedge accounting treatment, the periodic swap settlements, as well as certain other derivative related yield adjustments are recorded in “Realized investment gains (losses), net”, and are included in adjusted operating income to reflect the after-hedge yield of the underlying instruments. In certain instances, when these derivative contracts are terminated or offset before their final maturity, the resulting realized gains or losses are recognized in adjusted operating income over periods that generally approximate the expected terms of the derivatives or underlying instruments in order for adjusted operating income to reflect the after-hedge yield of the underlying instruments. Included in the amounts

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

shown in the table above are gains on certain derivatives contracts that were terminated or offset in prior periods of $16 million and $13 million for the three months ended September 30, 2012 and 2011, respectively, and $46 million and $37 million for the nine months ended September 30, 2012 and 2011, respectively. Additionally, as of September 30, 2012, there was a $593 million deferred net gain related to certain derivative contracts that were terminated or offset in prior periods, primarily in the International Insurance segment.

Principal Source of Earnings. The Company conducts certain activities for which realized investment gains and losses are a principal source of earnings for its businesses and therefore included in adjusted operating income, particularly within the Company’s Asset Management segment. For example, Asset Management’s strategic investing business makes investments for sale or syndication to other investors or for placement or co-investment in the Company’s managed funds and structured products. The realized investment gains and losses associated with the sale of these strategic investments, as well as related derivative results, are a principal activity for this business and included in adjusted operating income. In addition, the realized investment gains and losses associated with loans originated by the Company’s commercial mortgage operations, as well as related derivative results and retained mortgage servicing rights, are a principal activity for this business and included in adjusted operating income. The amounts shown in the table above for the nine months ended September 30, 2012 reflect the impact of the Asset Management segment’s out of period adjustment discussed above.

Other items reflected as adjustments to Realized investment gains (losses), net

The following table sets forth certain other items excluded from adjusted operating income and reflected as an adjustment to “Realized investment gains (losses), net” for purposes of calculating adjusted operating income:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Net gains (losses) from:				
Other trading account assets	$ 26	$ (104)	$ 59	$ (47)
Foreign currency exchange movements	$ (347)	$ 1,316	$ (223)	$ 1,093
Other activities	$ (8)	$ (49)	$ 30	$ (103)

Other Trading Account Assets. The Company has certain investments in its general account portfolios that are classified as trading. These trading investments are carried at fair value and included in “Other trading account assets, at fair value” on the Company’s statements of financial position. Realized and unrealized gains and losses for these investments are recorded in “Asset management fees and other income.” Consistent with the exclusion of realized investment gains and losses with respect to other investments managed on a consistent basis, the net gains or losses on these investments are excluded from adjusted operating income.

Foreign Currency Exchange Movements. The Company has certain assets and liabilities for which, under U.S. GAAP, the changes in value, including those associated with changes in foreign currency exchange rates during the period, are recorded in “Asset management fees and other income.” To the extent the foreign currency exposure on these assets and liabilities is economically hedged or considered part of the Company’s capital funding strategies for its international subsidiaries, the change in value included in “Asset management fees and other income” is excluded from adjusted operating income. The amounts in the table above are largely driven by non-yen denominated insurance liabilities in the Company’s Japanese insurance operations. The insurance liabilities are supported by investments denominated in corresponding currencies, including a significant portion designated as available-for-sale. While these non-yen denominated assets and liabilities are economically hedged, under U.S. GAAP, unrealized gains and losses on available-for-sale investments, including those arising

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

from foreign currency exchange rate movements, are recorded in “Accumulated other comprehensive income (loss),” while the non-yen denominated liabilities are re-measured for foreign currency exchange rate movements, and the related change in value is recorded in earnings within “Asset management fees and other income.” Due to this non-economic volatility that is reflected in U.S. GAAP earnings, the change in value recorded within “Asset management fee and other income” is excluded from adjusted operating income.

Included in the $1,093 million net gain for the nine months ended September 30, 2011 is an out of period adjustment recorded in the first quarter of 2011 that decreased income from continuing operations before equity in earnings of operating joint ventures by $95 million.

Other Activities. The Company excludes certain other items from adjusted operating income that are consistent with similar adjustments described above. The significant items within other activities shown in the table above included the following:

In connection with the settlement of disputes arising out of the Chapter 11 bankruptcy petition filed by Lehman Brothers Holdings Inc., the Company recorded additional losses of $65 million in the first quarter of 2011 related to a portion of its counterparty exposure on derivative transactions it had previously held with Lehman Brothers and its affiliates. These losses are recorded within “Asset management fees and other income” within the Company’s Corporate and Other operations. Consistent with the exclusion of credit-related losses recorded in “Realized investment gains (losses), net”, the impact of this settlement is excluded from adjusted operating income.” In the second quarter of 2012, the Company recorded a $12 million estimated recovery of this settlement, which is also excluded from adjusted operating income.

The Company records an adjustment for non-performance risk that relates to the uncollateralized portion of certain derivative contracts between a subsidiary of the Company and third parties. These adjustments are recorded within “Asset management fees and other income.” Consistent with the exclusion of the mark-to-market on derivatives recorded in “Realized investment gains (losses), net”, the impact of the non-performance risk is excluded from adjusted operating income. The net impact of the non-performance risk was to exclude from adjusted operating income net losses of $2 million and $45 million for the three months ended September 30, 2012 and 2011, respectively, and net gains of $32 million and net losses of $33 million for the nine months ended September 30, 2012 and 2011, respectively.

Related charges

Charges that relate to realized investment gains and losses are also excluded from adjusted operating income, and include the following:

• The portion of the amortization of deferred policy acquisition costs, value of business acquired, unearned revenue reserves and deferred sales inducements for certain products that is related to net realized investment gains and losses.

- • Policyholder dividends and interest credited to policyholders’ account balances that relate to certain foreign life policies and certain domestic group life policies, respectively, that pass back certain realized investment gains and losses to the policyholder, and reserves for future policy benefits for certain policies where cash flows are affected by net realized investment gains and losses.

- • Market value adjustments paid or received upon a contractholder’s surrender of certain of the Company’s annuity products as these amounts mitigate the net realized investment gains or losses incurred upon the disposition of the underlying invested assets.

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

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

Certain products included in the Retirement and International Insurance segments are experience-rated in that investment results associated with these products are expected to ultimately accrue to contractholders. The majority of investments supporting these experience-rated products are classified as trading and are carried at fair value, with realized and unrealized gains and losses reported in “Asset management fees and other income.” To a lesser extent, these experience-rated products are also supported by derivatives and commercial mortgage and other loans. The derivatives are carried at fair value, with realized and unrealized gains and losses reported in “Realized investment gains (losses), net.” The commercial mortgage and other loans are carried at unpaid principal, net of unamortized discounts and an allowance for losses, with gains and losses on sales and changes in the valuation allowance for commercial mortgage and other loans reported in “Realized investment gains (losses), net.”

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

Divested businesses

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

In July 2012, the Company announced its decision to cease sales of group long-term care insurance reflecting the challenging economics of the long-term care market including the continued low interest rate environment as well as its desire to focus resources on its core group life and disability businesses. The Company discontinued sales of group long-term care products effective August 1, 2012, or a later date as may be required by specific state law. The Company notified its clients of its intent to continue to accept enrollments on existing group long-term care contracts through June 30, 2013 or later as required by contractual provisions. In March 2012, the Company also discontinued sales of individual long-term care products. As a result of the decision to wind down this business, the Company has reflected the results of the long-term care insurance business, previously reported within the Group Insurance segment, as a divested business for all periods presented.

Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests

Equity in earnings of operating joint ventures, on a pre-tax basis, are included in adjusted operating income as these results are a principal source of earnings. These earnings are reflected on a U.S. GAAP basis on an after-tax basis as a separate line on the Company’s Unaudited Interim Consolidated Statements of Operations.

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Earnings attributable to noncontrolling interests are excluded from adjusted operating income. Earnings attributable to noncontrolling interests represents the portion of earnings from consolidated entities that relates to the equity interests of minority investors, and are reflected on a U.S. GAAP basis as a separate line on the Company’s Unaudited Interim Consolidated Statements of Operations.

The summary below reconciles adjusted operating income before income taxes for the Financial Services Businesses to income from continuing operations before income taxes and equity in earnings of operating joint ventures:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Adjusted Operating Income before income taxes for Financial Services Businesses by Segment:				
Individual Annuities	$ 207	$ (192)	$ 735	$ 289
Retirement	110	111	413	454
Asset Management	187	123	356	504
Total U.S. Retirement Solutions and Investment Management Division	504	42	1,504	1,247
Individual Life	112	111	285	344
Group Insurance	35	45	28	121
Total U.S. Individual Life and Group Insurance Division	147	156	313	465
International Insurance	783	660	2,070	1,788
Total International Insurance Division	783	660	2,070	1,788
Corporate Operations	(452)	(349)	(1,079)	(858)
Total Corporate and Other	(452)	(349)	(1,079)	(858)
Adjusted Operating Income before income taxes for Financial Services Businesses	982	509	2,808	2,642
Reconciling items:				
Realized investment gains (losses), net, and related adjustments	(1,951)	3,385	(1,609)	3,175
Charges related to realized investment gains (losses), net	648	(1,568)	498	(1,732)
Investment gains (losses) on trading account assets supporting insurance liabilities, net	264	10	502	170
Change in experience-rated contractholder liabilities due to asset value changes	(254)	68	(446)	(76)
Divested businesses	(685)	43	(657)	49
Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests	(40)	(87)	(27)	(201)

Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures for Financial Services Businesses	(1,036)	2,360	1,069	4,027
Income from continuing operations before income taxes and equity in earnings of operating joint ventures for Closed Block Business	69	46	97	91
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures	$ (967)	$ 2,406	$ 1,166	$ 4,118

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

The U.S. Retirement Solutions and Investment Management Division and U.S. Individual Life and Group Insurance Division results reflect deferred policy acquisition costs as if the individual annuity business and group insurance business were stand-alone operations. The elimination of intersegment costs capitalized in accordance with this policy is included in consolidating adjustments within Corporate and Other operations.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Financial Services Businesses:				
Individual Annuities	$ 1,018	$ 905	$ 2,944	$ 2,736
Retirement	1,162	1,171	3,511	3,625
Asset Management	634	513	1,656	1,717
Total U.S. Retirement Solutions and Investment Management Division	2,814	2,589	8,111	8,078
Individual Life	948	643	2,527	2,131
Group Insurance	1,420	1,447	4,203	4,222
Total U.S. Individual Life and Group Insurance Division	2,368	2,090	6,730	6,353
International Insurance	8,179	5,130	20,459	14,499
Total International Insurance Division	8,179	5,130	20,459	14,499
Corporate Operations	(109)	(38)	(306)	(132)
Total Corporate and Other	(109)	(38)	(306)	(132)
Total	13,252	9,771	34,994	28,798
Reconciling items:				
Realized investment gains (losses), net, and related adjustments	(1,954)	3,385	(1,613)	3,175
Charges related to realized investment gains (losses), net	(27)	(21)	(79)	(88)
Investment gains (losses) on trading account assets supporting insurance liabilities, net	264	10	502	170
Divested businesses	170	188	520	509
Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests	(65)	(97)	(78)	(265)
Total Financial Services Businesses	11,640	13,236	34,246	32,299
Closed Block Business	1,504	1,695	4,657	5,046

Total per Unaudited Interim Consolidated Financial Statements	$ 13,144	$ 14,931	$ 38,903	$ 37,345

The Asset Management segment revenues include intersegment revenues primarily consisting of asset-based management and administration fees as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Asset Management segment intersegment revenues	$ 136	$ 122	$ 395	$ 353

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Management has determined the intersegment revenues with reference to market rates. Intersegment revenues are eliminated in consolidation within Corporate and Other operations.

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

	September 30, 2012	December 31, 2011
	(in millions)	
Individual Annuities	$ 145,994	$ 123,394
Retirement	135,572	131,947
Asset Management	39,848	37,307
Total U.S. Retirement Solutions and Investment Management Division	321,414	292,648
Individual Life	45,784	43,061
Group Insurance	36,274	33,756
Total U.S. Individual Life and Group Insurance Division	82,058	76,817
International Insurance	186,261	168,961
Total International Insurance Division	186,261	168,961
Corporate Operations	10,576	12,574
Total Corporate and Other	10,576	12,574
Total Financial Services Businesses	600,309	551,000
Closed Block Business	71,389	69,244
Total	$ 671,698	$ 620,244

12. INCOME TAXES

The Company’s liability for income taxes includes the liability for unrecognized tax benefits, interest and penalties which relate to tax years still subject to review by the Internal Revenue Service (“IRS”) or other taxing authorities. Audit periods remain open for review until the statute of limitations has passed. Generally, for tax years which produce net operating losses, capital losses or tax credit carryforwards (“tax attributes”), the statute of limitations does not close, to the extent of these tax attributes, until the expiration of the statute of limitations for the tax year in which they are fully utilized. The completion of review or the expiration of the statute of limitations for a given audit period could result in an adjustment to the liability for income taxes. The statute of limitations for the 2004 through 2006 tax years will expire in June 2013, unless extended. The statute of limitations for the 2007 through 2008 tax years will expire in December 2013, unless extended. Tax years 2009 through 2011 are still open for IRS examination. It is reasonably possible that the total amount of unrecognized tax benefits will decrease anywhere from $0 to $83 million within the next 12 months due to the completion of the IRS examination for tax years 2007 through 2010.

During 2004 through 2006, the Company entered into two transactions that involved, among other things, the payment of foreign income taxes that were credited against the Company’s U.S. tax liability. On May 23, 2011, the IRS issued notices of proposed adjustments disallowing the foreign tax credits claimed and related transaction expenses. The total amount of the proposed adjustments for the transactions was approximately $200 million of tax and penalties. During the fourth quarter of 2011, the Company reached agreement with the IRS on the resolution of the proposed foreign tax credits disallowance. The impact to the 2011 results attributable to the settlement was an increase to tax expense of approximately $93 million. The settlement of the foreign tax credit

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

transactions for 2004 through 2006 marked the conclusion of the IRS audits for those years. As a result, all unrecognized tax positions plus interest relating to tax years prior to 2007 were recognized in 2011. As such, 2011 benefited from a reduction to the liability for unrecognized tax benefits of $70 million, including the impact from the foreign tax credit disallowance.

The dividends received deduction (“DRD”) reduces the amount of dividend income subject to U.S. tax and is a significant component of the difference between the Company’s effective tax rate and the federal statutory tax rate of 35%. The DRD for the current period was estimated using information from 2011, current year results, and was adjusted to take into account the current year’s equity market performance. The actual current year DRD can vary from the estimate based on factors such as, but not limited to, changes in the amount of dividends received that are eligible for the DRD, changes in the amount of distributions received from mutual fund investments, changes in the account balances of variable life and annuity contracts, and the Company’s taxable income before the DRD.

In August 2007, the IRS released Revenue Ruling 2007-54, which included, among other items, guidance on the methodology to be followed in calculating the DRD related to variable life insurance and annuity contracts. In September 2007, the IRS released Revenue Ruling 2007-61. Revenue Ruling 2007-61 suspended Revenue Ruling 2007-54 and informed taxpayers that the U.S. Treasury Department and the IRS intend to address through new guidance the issues considered in Revenue Ruling 2007-54, including the methodology to be followed in determining the DRD related to variable life insurance and annuity contracts. On February 13, 2012, the Obama Administration released the “General Explanations of the Administration’s Revenue Proposals.” One proposal would change the method used to determine the amount of the DRD. A change in the DRD, including the possible retroactive or prospective elimination of this deduction through guidance or legislation, could increase actual tax expense and reduce the Company’s consolidated net income. These activities had no impact on the Company’s results in 2011 or first nine months of 2012.

For tax years 2007 through 2011, the Company is participating in the IRS’s Compliance Assurance Program (“CAP”). Under CAP, the IRS assigns an examination team to review completed transactions contemporaneously during these tax years in order to reach agreement with the Company on how they should be reported in the tax returns. If disagreements arise, accelerated resolutions programs are available to resolve the disagreements in a timely manner before the tax returns are filed. It is management’s expectation this program will shorten the time period between the filing of the Company’s federal income tax returns and the IRS’s completion of its examination of the returns.

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Total income tax expense includes additional tax expense related to the utilization of deferred tax assets recorded in the Statement of Financial Position as of the acquisition date for Prudential Gibraltar Financial Life Insurance Company, Ltd. (“PGFL”) and the Star and Edison Businesses. The balance of additional U.S. GAAP tax expense to be recognized in the future related to the utilization of opening balance sheet deferred tax assets is as follows:

	PGFL	Star and Edison Businesses (in millions)	Total
Opening balance sheet deferred tax assets after valuation allowance that will result in additional tax expense	$ 42	$ 678	$ 720
Additional tax expense (benefit) recognized in the Statement of Operations:			
2009	6	0	6
2010	6	0	6
2011	(29)	252	223
Nine months 2012	1	343	344
Subtotal	(16)	595	579
Additional tax expense (benefit) recognized in Other Comprehensive Income	16	(19)	(3)
Additional tax expense to be recognized in future periods	$ 42	$ 102	$ 144

On January 1, 2012, the Star and Edison Businesses merged into Gibraltar Life Insurance Company, Ltd. The majority of additional U.S. tax expense recognized in the first nine months of 2012 is a result of the merger. The annual amount of additional tax expense related to the utilization of opening balance sheet deferred tax assets will be significantly lower in the future. As a result, the remaining $102 million of the additional tax expense will be recognized over an extended period of time.

13. FAIR VALUE OF ASSETS AND LIABILITIES

Fair Value Measurement—Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The authoritative guidance around fair value establishes a framework for measuring fair value that includes a hierarchy used to classify the inputs used in measuring fair value. The hierarchy prioritizes the inputs to valuation techniques into three levels. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement. The levels of the fair value hierarchy are as follows:

Level 1—Fair value is based on unadjusted quoted prices in active markets that are accessible to the Company for identical assets or liabilities. These generally provide the most reliable evidence and are used to measure fair value whenever available. The Company’s

Level 1 assets and liabilities primarily include certain cash equivalents and short term investments, equity securities and derivative contracts that trade on an active exchange market.

Level 2—Fair value is based on significant inputs, other than quoted prices included in Level 1, that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability through corroboration with observable market data. Level 2 inputs include quoted market prices in active markets for similar assets and liabilities, quoted market prices in markets that are not active for identical or similar assets or liabilities, and other market observable inputs. The Company’s Level 2 assets and liabilities

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

include: fixed maturities (corporate public and private bonds, most government securities, certain asset-backed and mortgage-backed securities, etc.), certain equity securities (mutual funds, which do not actively trade and are priced based on a net asset value), certain commercial mortgage loans, short-term investments and certain cash equivalents (primarily commercial paper), and certain over-the-counter derivatives.

Level 3—Fair value is based on at least one or more significant unobservable inputs for the asset or liability. The assets and liabilities in this category may require significant judgment or estimation in determining the fair value. The Company’s Level 3 assets and liabilities primarily include: certain private fixed maturities and equity securities, certain manually priced public equity securities and fixed maturities, certain highly structured over-the-counter derivative contracts, certain commercial mortgage loans, certain consolidated real estate funds for which the Company is the general partner, and embedded derivatives resulting from certain products with guaranteed benefits.

The Company has established policies and guidelines that require the establishment of valuation methodologies and consistent application of such methodologies. These policies and guidelines govern the use of inputs and price source hierarchies and provide controls around the valuation processes. These controls include appropriate review and analysis of prices against market activity or indicators of reasonableness, approval of price source changes, price overrides, methodology changes and classification of fair value hierarchy levels. The valuation policies and guidelines are reviewed and updated as appropriate.

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Assets and Liabilities by Hierarchy Level—The tables below present the balances of assets and liabilities measured at fair value on a recurring basis, as of the dates indicated.

	As of September 30, 2012				
	Level 1	Level 2	Level 3 (in millions)	Netting(1)	Total
Fixed maturities, available-for-sale:					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	$ 0	$ 15,567	$ 66	$	$ 15,633
Obligations of U.S. states and their political subdivisions	0	3,110	0		3,110
Foreign government bonds	0	86,737	3		86,740
Corporate securities	0	133,919	1,676		135,595
Asset-backed securities	0	7,981	3,199		11,180
Commercial mortgage-backed securities	0	11,933	183		12,116
Residential mortgage-backed securities	0	8,996	11		9,007
Subtotal	0	268,243	5,138		273,381
Trading account assets supporting insurance liabilities:					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	0	185	9		194
Obligations of U.S. states and their political subdivisions	0	261	0		261
Foreign government bonds	0	756	0		756
Corporate securities	0	12,057	96		12,153
Asset-backed securities	0	805	345		1,150
Commercial mortgage-backed securities	0	2,012	83		2,095
Residential mortgage-backed securities	0	1,878	2		1,880
Equity securities	854	130	19		1,003
Short-term investments and cash equivalents	538	102	0		640
Subtotal	1,392	18,186	554		20,132
Other trading account assets:					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	0	21	0		21
Foreign government bonds	2	50	0		52
Corporate securities	19	618	38		675
Asset-backed securities	0	260	54		314
Commercial mortgage-backed securities	0	81	10		91
Residential mortgage-backed securities	0	0	0		0
Equity securities	259	49	1,249		1,557
All other(2)	1	14,668	32	(11,537)	3,164
Subtotal	281	15,747	1,383	(11,537)	5,874
Equity securities, available-for-sale	5,277	2,369	346		7,992
Commercial mortgage and other loans	0	180	68		248
Other long-term investments	484	77	1,014		1,575
Short-term investments	6,571	2,673	0		9,244

Cash equivalents	1,999	7,368	0		9,367
Other assets	64	113	8		185
Subtotal excluding separate account assets	16,068	314,956	8,511	(11,537)	327,998
Separate account assets(3)	40,889	186,282	20,339		247,510
Total assets	$ 56,957	$ 501,238	$ 28,850	$ (11,537)	$ 575,508
Future policy benefits	$ 0	$ 0	$ 3,638	$	$ 3,638
Other liabilities	0	8,460	395	(8,290)	565
Total liabilities	$ 0	$ 8,460	$ 4,033	$ (8,290)	$ 4,203

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	As of December 31, 2011 (4)				
	Level 1	Level 2	Level 3 (in millions)	Netting(1)	Total
Fixed maturities, available-for-sale:					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	$ 0	$ 15,066	$ 66	$	$ 15,132
Obligations of U.S. states and their political subdivisions	0	2,740	0		2,740
Foreign government bonds	0	77,010	25		77,035
Corporate securities	12	125,650	1,450		127,112
Asset-backed securities	0	8,165	2,528		10,693
Commercial mortgage-backed securities	0	11,935	145		12,080
Residential mortgage-backed securities	0	9,840	16		9,856
Subtotal	12	250,406	4,230		254,648
Trading account assets supporting insurance liabilities:					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	0	177	9		186
Obligations of U.S. states and their political subdivisions	0	254	0		254
Foreign government bonds	0	608	0		608
Corporate securities	0	11,004	109		11,113
Asset-backed securities	0	1,010	357		1,367
Commercial mortgage-backed securities	0	2,226	21		2,247
Residential mortgage-backed securities	0	1,842	2		1,844
Equity securities	769	122	20		911
Short-term investments and cash equivalents	684	267	0		951
Subtotal	1,453	17,510	518		19,481
Other trading account assets:					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	0	31	0		31
Obligations of U.S. states and their political subdivisions	0	0	0		0
Foreign government bonds	2	45	0		47
Corporate securities	14	502	39		555
Asset-backed securities	0	593	59		652
Commercial mortgage-backed securities	0	96	14		110
Residential mortgage-backed securities	0	94	2		96
Equity securities	305	40	1,276		1,621
All other(2)	15	13,547	93	(11,222)	2,433
Subtotal	336	14,948	1,483	(11,222)	5,545
Equity securities, available-for-sale	5,004	2,171	360		7,535
Commercial mortgage and other loans	0	514	86		600
Other long-term investments	193	(11)	1,110		1,292
Short-term investments	5,506	3,254	0		8,760
Cash equivalents	2,667	6,762	0		9,429
Other assets	3	86	9		98
Subtotal excluding separate account assets	15,174	295,640	7,796	(11,222)	307,388

Separate account assets(3)	40,319	158,703	19,358		218,380
Total assets	$ 55,493	$ 454,343	$ 27,154	$ (11,222)	$ 525,768
Future policy benefits	$ 0	$ 0	$ 2,886	$	$ 2,886
Other liabilities	0	8,013	285	(7,854)	444
Total liabilities	$ 0	$ 8,013	$ 3,171	$ (7,854)	$ 3,330

(1) “Netting” amounts represent cash collateral of $3,247 million and $3,368 million as of September 30, 2012 and December 31, 2011, respectively, and the impact of offsetting asset and liability positions held with the same counterparty**.**

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

(2) Primarily represents derivative assets.
(3) Separate account assets represent segregated funds that are invested for certain customers. Investment risks associated with market value changes are borne by the customers, except to the extent of minimum guarantees made by the Company with respect to certain accounts. Separate account assets classified as Level 3 consist primarily of real estate and real estate investment funds. Separate account liabilities are not included in the above table as they are reported at contract value and not fair value in the Company’s Unaudited Interim Consolidated Statement of Financial Position.
(4) Includes reclassifications to conform to current period presentation.

The methods and assumptions the Company uses to estimate the fair value of assets and liabilities measured at fair value on a recurring basis are summarized below.

Fixed Maturity Securities—The fair values of the Company’s public fixed maturity securities are generally based on prices obtained from independent pricing services. Prices from pricing services are sourced from multiple vendors, and a vendor hierarchy is maintained by asset type based on historical pricing experience and vendor expertise. The Company generally receives prices from multiple pricing services for each security, but ultimately uses the price from the pricing service highest in the vendor hierarchy based on the respective asset type. Consistent with the fair value hierarchy described above, securities with validated quotes from pricing services are generally reflected within Level 2, as they are primarily based on observable pricing for similar assets and/or other market observable inputs. If the pricing information received from third party pricing services is not reflective of market activity or other inputs observable in the market, the Company may challenge the price through a formal process with the pricing service. If the pricing service updates the price to be more consistent with the presented market observations, the security remains within Level 2.

Internally-developed valuations or indicative broker quotes are also used to determine fair value in circumstances where vendor pricing is not available, or where the Company ultimately concludes that pricing information received from the independent pricing service is not reflective of market activity. If the Company concludes the values from both pricing services and brokers are not reflective of market activity, it may over-ride the information from the pricing service or broker with an internally-developed valuation. As of September 30, 2012 and December 31, 2011, over-rides on a net basis were not material. These estimates may use significant unobservable inputs, which reflect the Company’s own assumptions about the inputs market participants would use in pricing the asset. Pricing service over-rides, internally-developed valuations and indicative broker quotes are generally included in Level 3 in the fair value hierarchy.

The fair value of private fixed maturities, which are comprised of investments in private placement securities, originated by internal private asset managers, are primarily determined using a discounted cash flow model. In cases where these models primarily use observable inputs, the securities have been reflected within Level 2. For certain private fixed maturities, the discounted cash flow model may also incorporate significant unobservable inputs, which reflect the Company’s own assumptions about the inputs market participants would use in pricing the asset. In these cases, a Level 3 classification is used.

Private fixed maturities also include debt investments in funds that, in addition to a stated coupon, pay a return based upon the results of the underlying portfolios. The fair values of these securities are determined by reference to the funds’ net asset value (“NAV”). Since the NAV at which the funds trade can be observed by redemption and subscription transactions between third parties, the fair values of these investments have been reflected within Level 2 in the fair value hierarchy.

Trading Account Assets—Trading account assets (including trading account assets supporting insurance liabilities) consist primarily of public corporate bonds, treasuries, equity securities and derivatives whose fair values are determined consistent with similar instruments described above under “Fixed Maturity Securities” and below under “Equity Securities” and “Derivative Instruments.”

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Equity Securities—Equity securities consist principally of investments in common and preferred stock of publicly traded companies, perpetual preferred stock, privately traded securities, as well as mutual fund shares. The fair values of most publicly traded equity securities are based on quoted market prices in active markets for identical assets and are classified within Level 1 in the fair value hierarchy. Estimated fair values for most privately traded equity securities are determined using valuation and discounted cash flow models that require a substantial level of judgment. As these models may use unobservable inputs, most privately traded equity securities are classified within Level 3. The fair values of mutual fund shares that transact regularly (but do not trade in active markets because they are not publicly available) are based on transaction prices of identical fund shares and are classified within Level 2 in the fair value hierarchy. The fair values of perpetual preferred stock are based on inputs obtained from independent pricing services that are primarily based on indicative broker quotes, as the directly observable market inputs are not available. As a result, the fair values of perpetual preferred stock are classified as Level 3.

Commercial Mortgage and Other Loans—The fair value of commercial mortgage loans held for investment (i.e. interim portfolio) and accounted for using the Fair Value Option are determined based on the present value of the expected future cash flows discounted at the appropriate U.S. Treasury rate, adjusted for the current market spread for similar quality loans. The quality ratings for these loans, a primary determinant of the appropriate credit spread and a significant component of the pricing input, are based on internally-developed estimates. As a result, these loans are included in Level 3 in the fair value hierarchy.

The fair value of loans held and accounted for using the Fair Value Option is determined utilizing pricing indicators from the whole loan market, where investors are committed to purchase these loans at a pre-determined price, which is considered the principal exit market for these loans. The Company has evaluated the valuation inputs used for these assets, including the existence of pre-determined exit prices, the terms of the loans, prevailing interest rates and credit risk, and deemed that the primary pricing inputs are Level 2 inputs in the fair value hierarchy.

Other Long-Term Investments—Other long-term investments include limited partnerships which are consolidated because the Company is either deemed to exercise control or considered the primary beneficiary of a variable interest entity. These entities are considered investment companies and follow specialized industry accounting whereby their assets are carried at fair value. The investments held by these entities include various feeder fund investments in underlying master funds (whose underlying holdings generally include public fixed maturities, equity securities and mutual funds), as well as wholly-owned real estate held within other investment funds. The fair value and respective hierarchies of the feeder fund investments in master funds are generally determined by reference to the investments in the underlying master funds, with publicly traded equity securities based on quoted prices in active markets reflected in Level 1, and public fixed maturities and mutual funds priced via quotes from pricing services or observable data reflected in Level 2. The fair value of investments in funds that are subject to significant liquidity restrictions are reflected in Level 3.

The fair value of fund investments, where the fair value option has been elected, is primarily determined by the fund managers. Since the valuations may be based on unobservable market inputs and cannot be validated by the Company, these investments have been included within Level 3 in the fair value hierarchy.

The fair value of real estate held in consolidated investment funds is determined through an independent appraisal process. The appraisals generally utilize a discounted cash flow model. The cash flow approach is supplemented with replacement cost estimates and comparable recent sales data when available. These appraisals and the related assumptions are updated at least annually. Since many of the assumptions utilized are unobservable and are considered to be significant inputs to the valuation, the real estate investments within other long-term investments have been reflected within Level 3 in the fair value hierarchy.

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Derivative Instruments—Derivatives are recorded at fair value either as assets, within “Other trading account assets,” or “Other long-term investments,” or as liabilities, within “Other liabilities,” except for embedded derivatives which are recorded with the associated host contract. The fair values of derivative contracts are determined based on quoted prices in active exchanges or through the use of valuation models. The fair values of derivative contracts can be affected by changes in interest rates, foreign exchange rates, commodity prices, credit spreads, market volatility, expected returns, non-performance risk, liquidity and other factors. Liquidity valuation adjustments are made to reflect the cost of exiting significant risk positions, and consider the bid-ask spread, maturity, complexity, and other specific attributes of the underlying derivative position.

The Company’s exchange-traded futures and options include treasury futures, eurodollar futures, commodity futures, eurodollar options and commodity options. Exchange-traded futures and options are valued using quoted prices in active markets and are classified within Level 1 in the fair value hierarchy.

The majority of the Company’s derivative positions is traded in the over-the-counter (“OTC”) derivative market and are classified within Level 2 in the fair value hierarchy. OTC derivatives classified within Level 2 are valued using models that utilize actively quoted or observable market input values from external market data providers, third-party pricing vendors and/or recent trading activity. The Company’s policy is to use mid-market pricing in determining its best estimate of fair value. The fair values of most OTC derivatives, including interest rate and cross currency swaps, currency forward contracts, commodity swaps, commodity forward contracts, single name credit default swaps, loan commitments held for sale and to-be-announced (or TBA) forward contracts on highly rated mortgage-backed securities issued by U.S. government sponsored entities are determined using discounted cash flow models. The fair values of European style option contracts are determined using Black-Scholes option pricing models. These models’ key inputs include the contractual terms of the respective contract, along with significant observable inputs, including interest rates, currency rates, credit spreads, equity prices, index dividend yields, non-performance risk, volatility and other factors.

The vast majority of the Company’s derivative agreements are with highly rated major international financial institutions. To reflect the market’s perception of its own and the counterparty’s non-performance risk, the Company incorporates additional spreads over London Interbank Offered Rate (“LIBOR”) into the discount rate used in determining the fair value of OTC derivative assets and liabilities that are not otherwise collateralized.

Derivatives classified as Level 3 include first-to-default credit basket swaps, look-back equity options and other structured products. These derivatives are valued based upon models with some significant unobservable market inputs or inputs from less actively traded markets. The fair values of first-to-default credit basket swaps are derived from relevant observable inputs (e.g. individual credit default spreads, interest rates and recovery rates), and unobservable model-specific input values such as correlation between different credits within the same basket. Look-back equity options and other structured options and derivatives are valued using simulation models such as the Monte Carlo and other techniques. The input values for look-back equity options are derived from observable market indices (e.g. interest rates, dividend yields and equity indices), and unobservable model-specific input values including certain volatility parameters. Level 3 methodologies are validated through periodic comparison of the Company’s fair values to broker-dealer values.

Cash Equivalents and Short-Term Investments—Cash equivalents and short-term investments **i**nclude money market instruments, commercial paper and other highly liquid debt instruments. Certain money market instruments are valued using unadjusted quoted prices in active markets that are accessible for identical assets and are primarily classified as Level 1. The remaining instruments in the Cash Equivalents and Short-term Investments category are typically not traded in active markets; however, their fair values are generally based on

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

market observable inputs and, accordingly, these investments have primarily been classified within Level 2 in the fair value hierarchy.

Separate Account Assets—Separate Account Assets include fixed maturity securities, treasuries, equity securities and real estate investments for which values are determined consistent with similar instruments described above under “Fixed Maturity Securities,” “Equity Securities” and “Other Long-Term Investments.”

Other Liabilities—Other liabilities include derivative instruments, the fair values of which are determined consistent with similar derivative instruments described above under “Derivative Instruments.”

Future Policy Benefits—The liability for future policy benefits primarily includes general account liabilities for guarantees on variable annuity contracts, including guaranteed minimum accumulation benefits (“GMAB”), guaranteed minimum withdrawal benefits (“GMWB”) and guaranteed minimum income and withdrawal benefits (“GMIWB”), accounted for as embedded derivatives. The fair values of the GMAB, GMWB and GMIWB liabilities are calculated as the present value of future expected benefit payments to customers less the present value of assessed rider fees attributable to the embedded derivative feature. This methodology could result in either a liability or contra-liability balance, given changing capital market conditions and various policyholder behavior assumptions. Since there is no observable active market for the transfer of these obligations, the valuations are calculated using internally-developed models with option pricing techniques. The models are based on a risk neutral valuation framework and incorporate premiums for risks inherent in valuation techniques, inputs, and the general uncertainty around the timing and amount of future cash flows. The determination of these risk premiums requires the use of management judgment.

The significant inputs to the valuation models for the embedded derivatives associated with the optional living benefit features of the Company’s variable annuity products include capital market assumptions, such as interest rate and implied volatility assumptions, the Company’s market-perceived risk of its own non-performance (“NPR”), as well as various assumptions that are actuarially determined, including lapse rates, benefit utilization rates, withdrawal rates, and mortality rates. Since many of these assumptions are unobservable and are considered to be significant inputs to the liability valuation, the liability included in future policy benefits has been reflected within Level 3 in the fair value hierarchy.

Capital market inputs and actual policyholders’ account values are updated each quarter based on capital market conditions as of the end of the quarter, including interest rates, equity markets and implied volatility. In the risk neutral valuation, interest rates are used to both grow the policyholders’ account values and discount all projected future cash flows. The Company’s discount rate assumption is based on the LIBOR swap curve, and is adjusted for NPR, as discussed below. Assuming all other assumptions remain unchanged, a decline in interest rates will generally cause account values to grow more slowly, increasing future expected benefit payments, as well as decreasing the discounting impact in the present value calculation, both of which would cause increases in the fair value of the liability. The opposite impacts occur as interest rates rise. Implied volatility also impacts the estimate of future expected benefit payments, as discussed below.

Actuarial assumptions are reviewed at least annually, and updated based upon historical experience giving consideration to any observable market data, including available industry studies or market transactions such as acquisitions and reinsurance transactions. Assumptions relating to contractholder behavior such as lapse, benefit utilization, withdrawal, and mortality rates, are based on experience by product type and/or year of contract issuance, as well as available industry studies. Unless a material change in contractholder behavior or mortality experience that the Company feels is indicative of a long term trend is observed in an interim period, assumptions related to contractholder behavior and mortality are generally updated in the third quarter of each

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

year by considering recent experience that has occurred during the period from the most recent update to the expected amounts or updates to industry studies. These assumptions require the use of management judgment and are discussed in further detail below.

Level 3 Assets and Liabilities by Price Source—The table below presents the balances of Level 3 assets and liabilities measured at fair value with their corresponding pricing sources.

	As of September 30, 2012		
	Internal(1)	External(2)	Total
		(in millions)	
U.S. Treasury securities and obligations of U.S. government authorities and agencies	$ 0	$ 75	$ 75
Foreign government bonds	3	0	3
Corporate securities	1,034	776	1,810
Asset-backed securities	294	3,304	3,598
Commercial mortgage-backed securities	85	191	276
Residential mortgage-backed securities	3	10	13
Equity securities	123	1,491	1,614
Commercial mortgage and other loans	68	0	68
Other long-term investments	8	1,006	1,014
Other assets	40	0	40
Subtotal excluding separate account assets(3)	1,658	6,853	8,511
Separate account assets	19,646	693	20,339
Total assets	$ 21,304	$ 7,546	$ 28,850
Future policy benefits	$ 3,638	$ 0	$ 3,638
Other liabilities	1	394	395
Total liabilities	$ 3,639	$ 394	$ 4,033

(1) Represents valuations reflecting both internally-derived and market inputs, as well as third-party pricing information or quotes. See below for additional information related to internally-developed valuation for significant items in the above table.
(2) Represents unadjusted prices from independent pricing services and independent indicative broker quotes where pricing inputs are not readily available.
(3) Includes assets classified as fixed maturities available-for-sale, trading account assets supporting insurance liabilities and other trading account assets.

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Quantitative Information Regarding Internally-Priced Level 3 Assets and Liabilities—The table below presents quantitative information on significant internally-priced Level 3 assets and liabilities for which the investment risks associated with market value changes are borne by the Company.

	As of September 30, 2012			
	Fair Value (in millions)	**Valuation Techniques**	**Unobservable Inputs**	**Range (Weighted Average)**
Assets:				
Corporate securities	$ 1,034	Discounted cash flow	Discount rate	1.4% - 17.5% (10.66%)
		Market comparables	EBITDA multiples(1)	5.4X - 8.5X (6.9X)
		Cap at call price	Call price	100% - 101% (100.19%)
		Liquidation	Liquidation value	25% - 93.8% (83.53%)
Asset-backed securities	$ 294	Discounted cash flow	Prepayment rate	2.8% - 20% (6.17%)
			Default rate	0.5% - 2.5% (0.77%)
			Loss severity	35% - 40% (35.49%)
			Liquidity premium	0.5% - 2.75% (1.32%)
			Average life (years)	0.1 years - 4.73 years (2.81 years)
			Comparable spreads	0.3% - 20% (2.89%)
			Comparable security yields	0.38% - 21.9% (10.54%)
Liabilities:				
Future policy benefits	$ 3,638	Discounted cash flow	Lapse rate	0% - 14%
			NPR spread	0.24% - 1.82%
			Utilization rate	70% - 94%
			Withdrawal rate	85% - 100%
			Mortality rate(2)	0% - 13%
			Equity volatility curve	19% - 34%

(1) EBITDA multiples represent multiples of earnings before interest, taxes, depreciation and amortization, and are amounts used when the reporting entity has determined that market participants would use such multiples when pricing the investments.
(2) Range reflects the mortality rate for the vast majority of business with living benefits, with policyholders ranging from 35 to 90 years old. While the majority of living benefits have a minimum age requirement, certain benefits do not have an age restriction. This results in contractholders for certain benefits with mortality rates approaching 0%.

Sensitivity to Changes in Unobservable Inputs—The following is a general description of sensitivities of significant unobservable inputs and their impact on the fair value measurement, for the assets and liabilities reflected in the table above.

Corporate Securities—Internally-priced corporate securities classified in Level 3 include certain below investment grade watchlist and distressed fixed maturity securities. For securities where discounted cash flows are used, the primary unobservable input is an internally-developed discount rate. Significant increases (decreases) in the discount rate would result in a significantly lower (higher) fair value measurement. In certain cases, the Company uses an estimated liquidation value of the borrower or underlying assets. The Company also applies market comparables, such as earnings before interest, taxes, depreciation and amortization (EBITDA) multiples for certain securities. In isolation, an increase (decrease) in the value of these inputs would result in a higher (lower) fair value measurement.

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Asset-Backed Securities—Asset-backed securities classified in Level 3 are primarily valued internally using a discounted cash flow technique. Unobservable inputs are the prepayment rate, default rate, loss severity, liquidity premium and comparable security spreads. In isolation, an increase in prepayment rate or a decrease in default rate or loss severity would generally result in an increase in fair value, although the interrelationships between these inputs depend on specific market conditions. However, in stressed markets, prepayment rates tend to decrease, while default rates and loss severities tend to increase. These changes will result in a decrease in fair value. In other cases where a liquidity premium and/or comparable security spreads and yields are used, a significant increase in either of these inputs can produce a significant decrease in fair value.

Future Policy Benefits—Future policy benefits classified as Level 3 are calculated using internally-developed models with option pricing techniques. The models are based on a risk neutral valuation framework and incorporate premiums for risks inherent in valuation techniques, inputs and the general uncertainty around the timing and amount of future cash flows. As described above, the significant unobservable inputs to the valuation models for the embedded derivatives associated with the optional living benefit features of the Company’s variable annuity products include various assumptions that are actuarially determined, including lapse rates, benefit utilization rates, withdrawal rates and mortality rates as well as volatility assumptions and assumptions used to reflect NPR.

The Company’s dynamic lapse rate assumption adjusts the base lapse rate at the contract level based on a comparison of the actuarially calculated guaranteed amount and the current policyholder account value as well as other factors, such as the applicability of any surrender charges. The dynamic lapse adjustment reduces the base lapse rate based on the magnitude of the difference between the guaranteed amount and the account value. In-the-money contracts are those with a guaranteed benefit in excess of the current policyholder account value. Since in-the-money contracts are less likely to lapse, the dynamic lapse adjustment will reduce the lapse rate assumption for these contracts. For less in-the-money contracts, the lapse rate assumption will be closer to the base lapse rate. Lapse rates are also generally assumed to be lower for the period where surrender charges apply. A higher base lapse rate is applied to contracts in the year the surrender charge period expires.

To reflect NPR, the Company incorporates an additional spread over LIBOR into the discount rate used in the valuations of the embedded derivatives associated with its optional living benefit features. Since insurance liabilities are senior to debt, the Company believes that reflecting the financial strength ratings of the Company’s insurance subsidiaries in the valuation of the liability or asset appropriately takes into consideration NPR. The additional spread over LIBOR is determined taking into consideration publicly available information relating to the financial strength of the Company’s insurance subsidiaries, as indicated by the credit spreads associated with funding agreements issued by these subsidiaries. The Company adjusts these credit spreads to remove any illiquidity risk premium, which is subject to a floor based on a percentage of the credit spread. This additional spread is applied at an individual contract level and only to those individual living benefit contracts in a liability position and generally not to those in a contra-liability position. An increase in the spread over LIBOR increases the discounting impact in the present value calculation and will generally cause a decrease in the fair value of the liability.

The Company’s benefit utilization rate assumption estimates the percentage of contracts that will utilize the benefit during the contract duration, including the estimated timing of the first lifetime income withdrawal by the contractholder. These assumptions vary based on the product type, the age of the contractholder and the age of the contract. The utilization rate varies by product, based on the availability of an enhanced guarantee after a certain waiting period. For example, the utilization rates for a product with the opportunity to double the guaranteed value after a 10, 12 or 20 year accumulation period are adjusted based on contractholder experience related to such enhancement. Generally, the Company assumes a certain percentage of contractholders will utilize the guaranteed benefit (depending on the product type, contractholder age and contract age) and will begin

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

lifetime withdrawals at various time intervals from contract inception, with the remaining contractholders either beginning lifetime withdrawals immediately or never utilizing the benefit. The impact of changes in these assumptions is highly dependent on the contract type and age of the contractholder at the time of the sale and the timing of the first lifetime income withdrawal.

The Company’s withdrawal rate assumption estimates the magnitude of annual contractholder withdrawals relative to the maximum allowable amount under the contract. Larger differences in the withdrawal rate assumption compared to the contractual guaranteed income withdrawal percentage, either positive or negative, will generally result in a decrease in the fair value of the liability. Prior to the exhaustion of the contractholder’s total account value, the Company assumes contractholders will withdraw a certain percentage of the maximum allowable amount under the contract and will withdraw the maximum once the contractholder account value is completely exhausted.

Based on historical experience, the Company applies a set of age specific mortality rate adjustments compared to standard industry tables. For newly issued contracts, lower mortality rates are assumed in early durations. A mortality improvement assumption is also incorporated into the overall mortality table. Since the variable annuity living benefits generally provide for a minimum withdrawal benefit for life, increases in mortality rates will decrease the fair value of the liability, with the reverse being true with decreases in mortality rates.

Market volatility also impacts the estimate of future expected benefit payments. The Company uses an equity volatility curve based on third-party inputs. The curve starts with first year implied volatility and grades to a long-term realized volatility. The first year implied volatility determines the overall slope of the equity volatility curve. An increase in implied volatility will generally increase future expected benefit payments, causing an increase in the fair value of the liability.

Separate Account Assets—In addition to the significant internally-priced Level 3 assets and liabilities presented and described above, the Company also has internally-priced separate account assets reported within Level 3. Changes in the fair value of separate account assets are borne by customers and thus are offset by changes in separate account liabilities on the Company’s Unaudited Interim Consolidated Statement of Financial Position. As a result, changes in value associated with these investments do not impact the Company’s Unaudited Interim Consolidated Statement of Operations. In addition, fees earned by the Company related to the management of most separate account assets classified as Level 3 do not change due to changes in the fair value of these investments. Quantitative information about significant internally-priced Level 3 separate account assets is as follows:

Real Estate and Other Invested Assets—Separate account assets include $18,467 million of investments in real estate as of September 30, 2012 that are classified as Level 3 and reported at fair value. In general, these fair value estimates are based on property appraisal reports prepared by independent real estate appraisers. Key inputs and assumptions to the appraisal process include rental income and expense amounts, related growth rates, discount rates and capitalization rates. In cases where real estate investments are made through indirect investments, fair value is generally determined by the Company’s equity in net assets of the entities. The debt associated with real estate, other invested assets and the Company’s equity position in entities are externally valued. Because of the subjective nature of inputs and the judgment involved in the appraisal process, real estate investments and their corresponding debt are typically included in the Level 3 classification. Key unobservable inputs to real estate valuation include capitalization rates, which range from 4.75% to 10.5% (6.57% weighted average) and discount rates, which range from 6.25% to 12.0% (7.90% weighted average). Key unobservable inputs to real estate debt valuation include yield to maturity, which ranges from 2.17% to 7.64% (4.75% weighted average) and market spread over base rate, which ranges from 1.81% to 4.51%

(3.30% weighted average).

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

*Commercial Mortgage Loans—*Separate account assets include $1,107 million of commercial mortgage loans as of September 30, 2012 that are classified as Level 3 and reported at fair value. Commercial mortgage loans are primarily valued internally using discounted cash flow techniques, as described further under “Fair Value of Financial Instruments.” The primary unobservable input used is the spread to discount cash flows, which range from 1.70% to 5.67% (2.05% weighted average). In isolation, an increase (decrease) in the value of this input would result in a lower (higher) fair value measurement.

Transfers between Levels 1 and 2—Periodically there are transfers between Level 1 and Level 2 for foreign common stocks held in the Company’s Separate Account. In certain periods, an adjustment may be made to the fair value of these assets beyond the quoted market price to reflect events that occurred between the close of foreign trading markets and the close of U.S. trading markets for the respective day. Such an adjustment was made at June 30, 2012, wherein $2.9 billion of separate account equity investments transferred from Level 1 to Level 2. No such adjustments were made at September 30, 2012, March 31, 2012 or December 31, 2011. During the three months ended September 30, 2012, $2.1 billion of transfers from Level 2 to Level 1 were made for these Separate Account assets, resulting in a net basis of $0.8 billion of assets transferred from Level 1 to Level 2 for the nine months ended September 30, 2012. During the three and nine months ended September 30, 2011, $2.6 billion of transfers from Level 1 to Level 2 were made for these Separate Account assets.

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Changes in Level 3 assets and liabilities—The following tables provide summaries of the changes in fair values of Level 3 assets and liabilities as of the dates indicated, as well as the portion of gains or losses included in income attributable to unrealized gains or losses related to those assets and liabilities still held at the end of their respective periods.

	Three Months Ended September 30, 2012					
	Fixed Maturities Available-For-Sale - U.S. Government Authorities	Fixed Maturities Available-For-Sale - U.S. States	Fixed Maturities Available-For-Sale - Foreign Government Bonds	Fixed Maturities Available-For-Sale - Corporate Securities	Fixed Maturities Available-For-Sale - Asset-Backed Securities	Fixed Maturities Available-For-Sale - Commercial Mortgage-Backed Securities
				(in millions)		
Fair Value, beginning of period	$ 66	$ 0	$ 21	$ 1,635	$ 3,069	$ 186
Total gains (losses) (realized/unrealized):						
Included in earnings:						
Realized investment gains (losses), net	0	0	0	0	10	2
Included in other comprehensive income (loss)	0	0	0	46	22	7
Net investment income	0	0	0	2	7	1
Purchases	0	0	0	100	793	10
Sales	0	0	0	(91)	(381)	(2)
Issuances	0	0	0	0	0	0
Settlements	0	0	0	(42)	(105)	(7)
Foreign currency translation	0	0	0	3	2	0
Other(4)	0	0	(5)	5	0	0
Transfers into Level 3(1)	0	0	0	59	35	0
Transfers out of Level 3(1)	0	0	(13)	(41)	(253)	(14)
Fair Value, end of period	$ 66	$ 0	$ 3	$ 1,676	$ 3,199	$ 183
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2):						
Included in earnings:						
Realized investment gains (losses), net	$ 0	$ 0	$ 0	$ 0	$ 3	$ 0

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Three Months Ended September 30, 2012					
	Fixed Maturities Available-For-Sale - Residential Mortgage-Backed Securities	Trading Account Assets Supporting Insurance Liabilities-U.S. Government Authorities	Trading Account Assets Supporting Insurance Liabilities-Corporate Securities	Trading Account Assets Supporting Insurance Liabilities-Asset-Backed Securities	Trading Account Assets Supporting Insurance Liabilities-Commercial Mortgage-Backed Securities	Trading Account Assets Supporting Insurance Liabilities-Residential Mortgage-Backed Securities
	(in millions)					
Fair Value, beginning of period	$ 13	$ 9	$ 103	$ 390	$ 56	$ 2
Total gains (losses) (realized/unrealized):						
Included in earnings:						
Asset management fees and other income	0	0	0	6	0	0
Net investment income	0	0	0	1	0	0
Purchases	0	0	0	0	2	0
Sales	0	0	(4)	(5)	0	0
Issuances	0	0	0	0	0	0
Settlements	(2)	0	(5)	(20)	(1)	0
Transfers into Level 3(1)	0	0	2	3	43	0
Transfers out of Level 3(1)	0	0	0	(30)	(17)	0
Fair Value, end of period	$ 11	$ 9	$ 96	$ 345	$ 83	$ 2
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2):						
Included in earnings:						
Asset management fees and other income	$ 0	$ 0	$ (3)	$ 6	$ 0	$ 0

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Three Months Ended September 30, 2012				
	Trading Account Assets Supporting Insurance Liabilities-Equity Securities	Other Trading Account Assets-Corporate Securities	Other Trading Account Assets-Asset-Backed Securities (in millions)	Other Trading Account Assets-Commercial Mortgage-Backed Securities	Other Trading Account Assets-Residential Mortgage-Backed Securities
Fair Value, beginning of period	$ 19	$ 37	$ 54	$ 12	$ 1
Total gains (losses) (realized/unrealized):					
Included in earnings:					
Asset management fees and other income	0	0	2	1	0
Net investment income	0	0	0	0	0
Purchases	0	(1)	0	0	0
Sales	0	2	(1)	(2)	0
Issuances	0	0	0	0	0
Settlements	0	0	(1)	(1)	0
Foreign currency translation	0	0	0	0	0
Other(4)	0	0	1	0	(1)
Transfers into Level 3(1)	0	0	0	0	0
Transfers out of Level 3(1)	0	0	(1)	0	0
Fair Value, end of period	$ 19	$ 38	$ 54	$ 10	$ 0
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2):					
Included in earnings:					
Asset management fees and other income	$ 0	$ 0	$ 1	$ 0	$ 0

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Three Months Ended September 30, 2012				
	Other Trading Account Assets-Equity Securities	Other Trading Account Assets-All Other Activity	Equity Securities Available-for-Sale (in millions)	Commercial Mortgage and Other Loans	Other Long-term Investments
Fair Value, beginning of period	$ 1,222	$ 45	$ 355	$ 37	$ 1,042
Total gains (losses) (realized/unrealized):					
Included in earnings:					
Realized investment gains (losses), net	1	(16)	(1)	2	3
Asset management fees and other income	20	1	0	0	5
Included in other comprehensive income (loss)	0	0	(6)	0	0
Net investment income	0	0	0	0	(1)
Purchases	0	0	6	0	44
Sales	(2)	0	(9)	0	(3)
Issuances	0	0	0	0	0
Settlements	(32)	2	0	29	(45)
Foreign currency translation	7	0	1	0	0
Other(4)	0	0	0	0	11
Transfers into Level 3(1)	33	0	0	0	0
Transfers out of Level 3(1)	0	0	0	0	(42)
Fair Value, end of period	$ 1,249	$ 32	$ 346	$ 68	$ 1,014
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2):					
Included in earnings:					
Realized investment gains (losses), net	$ 0	$ (16)	$ 0	$ 2	$ 0
Asset management fees and other income	$ 22	$ 1	$ 0	$ 0	$ 20

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Three Months Ended September 30, 2012				
	Short-term Investments	Other Assets	Separate Account Assets(3)	Future Policy Benefits	Other Liabilities
			(in millions)		
Fair Value, beginning of period	$ 5	$ 8	$ 20,698	$ (3,054)	$ (298)
Total gains (losses) (realized/unrealized):					
Included in earnings:					
Realized investment gains (losses), net	(5)	0	0	(408)	(8)
Interest credited to policyholders’ account balances	0	0	303	0	0
Purchases	0	0	310	0	0
Sales	0	0	(184)	0	0
Issuances	0	0	0	(176)	(390)
Settlements	0	0	(592)	0	301
Transfers into Level 3(1)	0	0	29	0	0
Transfers out of Level 3(1)	0	0	(225)	0	0
Fair Value, end of period	$ 0	$ 8	$ 20,339	$ (3,638)	$ (395)
Unrealized gains (losses) for the period relating to those Level 3 assets and liabilities that were still held at the end of the period(2):					
Included in earnings:					
Realized investment gains (losses), net	$ (5)	$ 0	$ 0	$ (448)	$ (6)
Interest credited to policyholders’ account balances	$ 0	$ 0	$ 146	$ 0	$ 0

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Nine Months Ended September 30, 2012					
	Fixed Maturities Available-For-Sale-U.S. Government Authorities	Fixed Maturities Available-For- Sale-U.S. States	Fixed Maturities Available-For-Sale-Foreign Government Bonds	Fixed Maturities Available-For-Sale-Corporate Securities	Fixed Maturities Available-For-Sale-Asset-Backed Securities	Fixed Maturities Available-For-Sale-Commercial Mortgage-Backed Securities
	(in millions)					
Fair Value, beginning of period	$ 66	$ 0	$ 25	$ 1,450	$ 2,528	$ 145
Total gains (losses) (realized/unrealized):						
Included in earnings:						
Realized investment gains (losses), net	0	0	0	(25)	18	2
Included in other comprehensive income (loss)	0	0	0	176	52	18
Net investment income	0	0	0	6	22	(2)
Purchases	0	10	0	321	1,964	43
Sales	0	0	0	(130)	(425)	(2)
Issuances	0	0	0	0	0	0
Settlements	(2)	0	0	(228)	(450)	(11)
Foreign currency translation	0	0	0	(3)	(8)	(1)
Other(4)	2	0	(5)	3	0	0
Transfers into Level 3(1)	0	0	7	276	35	37
Transfers out of Level 3(1)	0	(10)	(24)	(170)	(537)	(46)
Fair Value, end of period	$ 66	$ 0	$ 3	$ 1,676	$ 3,199	$ 183
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2):						
Included in earnings:						
Realized investment gains (losses), net	$ 0	$ 0	$ 0	$ (1)	$ 9	$ 0

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Nine Months Ended September 30, 2012					
	Fixed Maturities Available-For-Sale-Residential Mortgage-Backed Securities	Trading Account Assets Supporting Insurance Liabilities-U.S. Government Authorities	Trading Account Assets Supporting Insurance Liabilities-Corporate Securities	Trading Account Assets Supporting Insurance Liabilities-Asset-Backed Securities	Trading Account Assets Supporting Insurance Liabilities-Commercial Mortgage-Backed Securities	Trading Account Assets Supporting Insurance Liabilities-Residential Mortgage-Backed Securities
	(in millions)					
Fair Value, beginning of period	$ 16	$ 9	$ 109	$ 357	$ 21	$ 2
Total gains (losses) (realized/unrealized):						
Included in earnings:						
Asset management fees and other income	0	0	(5)	10	1	0
Net investment income	1	0	0	4	0	0
Purchases	0	0	16	128	18	0
Sales	0	0	(8)	(5)	0	0
Issuances	0	0	0	0	0	0
Settlements	(6)	(2)	(15)	(87)	(1)	0
Other(4)	0	2	(2)	0	0	0
Transfers into Level 3(1)	0	0	5	3	80	0
Transfers out of Level 3(1)	0	0	(4)	(65)	(36)	0
Fair Value, end of period	$ 11	$ 9	$ 96	$ 345	$ 83	$ 2
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2):						
Included in earnings:						
Asset management fees and other income	$ 0	$ 0	$ (10)	$ 9	$ 1	$ 0

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Nine Months Ended September 30, 2012				
	Trading Account Assets Supporting Insurance Liabilities-Equity Securities	Other Trading Account Assets-Corporate Securities	Other Trading Account Assets-Asset-Backed Securities (in millions)	Other Trading Account Assets-Commercial Mortgage-Backed Securities	Other Trading Account Assets-Residential Mortgage-Backed Securities
Fair Value, beginning of period	$ 20	$ 39	$ 59	$ 14	$ 2
Total gains (losses) (realized/unrealized):					
Included in earnings:					
Asset management fees and other income	0	0	3	0	1
Net investment income	0	0	1	1	0
Purchases	0	1	0	0	0
Sales	0	(2)	(4)	(4)	(1)
Issuances	0	0	0	0	0
Settlements	0	0	(3)	(2)	(1)
Foreign currency translation	0	0	(1)	0	0
Other(4)	0	0	1	0	(1)
Transfers into Level 3(1)	0	0	0	2	0
Transfers out of Level 3(1)	(1)	0	(2)	(1)	0
Fair Value, end of period	$ 19	$ 38	$ 54	$ 10	$ 0
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2):					
Included in earnings:					
Asset management fees and other income	$ 1	$ 0	$ 2	$ 0	$ 0

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Nine Months Ended September 30, 2012				
	Other Trading Account Assets-Equity Securities	Other Trading Account Assets-All Other Activity	Equity Securities Available-for-Sale (in millions)	Commercial Mortgage and Other Loans	Other Long-term Investments
Fair Value, beginning of period	$ 1,276	$ 93	$ 360	$ 86	$ 1,110
Total gains (losses) (realized/unrealized):					
Included in earnings:					
Realized investment gains (losses), net	0	(65)	1	2	6
Asset management fees and other income	54	1	0	0	73
Included in other comprehensive income (loss)	0	0	21	0	0
Net investment income	0	0	0	0	5
Purchases	13	0	68	0	159
Sales	(31)	0	(17)	0	(23)
Issuances	0	0	0	0	0
Settlements	(88)	6	0	(20)	(261)
Foreign currency translation	(11)	0	(2)	0	2
Other(4)	3	(3)	0	0	7
Transfers into Level 3(1)	33	0	5	0	0
Transfers out of Level 3(1)	0	0	(90)	0	(64)
Fair Value, end of period	$ 1,249	$ 32	$ 346	$ 68	$ 1,014
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2):					
Included in earnings:					
Realized investment gains (losses), net	$ (1)	$ (65)	$ 0	$ 1	$ 1
Asset management fees and other income	$ 53	$ 1	$ 0	$ 0	$ 40

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Nine Months Ended September 30, 2012				
	Short-term investments	Other Assets	Separate Account Assets(3)	Future Policy Benefits	Other Liabilities
			(in millions)		
Fair Value, beginning of period	$ 0	$ 9	$ 19,358	$ (2,886)	$ (285)
Total gains (losses) (realized/unrealized):					
Included in earnings:					
Realized investment gains (losses), net	(9)	0	0	(255)	(25)
Asset management fees and other income	0	2	0	0	0
Interest credited to policyholders’ account balances	0	0	1,518	0	0
Purchases	9	0	2,154	0	0
Sales	0	(3)	(647)	0	0
Issuances	0	0	0	(497)	(401)
Settlements	0	0	(1,617)	0	319
Other(4)	0	0	0	0	(3)
Transfers into Level 3(1)	0	0	245	0	0
Transfers out of Level 3(1)	0	0	(672)	0	0
Fair Value, end of period	$ 0	$ 8	$ 20,339	$ (3,638)	$ (395)
Unrealized gains (losses) for the period relating to those Level 3 assets and liabilities that were still held at the end of the period(2):					
Included in earnings:					
Realized investment gains (losses), net	$ (9)	$ 0	$ 0	$ (340)	$ (25)
Asset management fees and other income	$ 0	$ 2	$ 0	$ 0	$ 0
Interest credited to policyholders’ account balances	$ 0	$ 0	$ 902	$ 0	$ 0

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Three Months Ended September 30, 2011					
	Fixed Maturities Available For Sale-U.S. Government Authorities	Fixed Maturities Available For Sale-Foreign Government Bonds	Fixed Maturities Available For Sale-Corporate Securities	Fixed Maturities Available For Sale-Asset-Backed Securities	Fixed Maturities Available For Sale-Commercial Mortgage-Backed Securities	Fixed Maturities Available For Sale-Residential Mortgage-Backed Securities
	(in millions)					
Fair Value, beginning of period	$ 0	$ 27	$ 1,278	$ 2,933	$ 105	$ 20
Total gains (losses) (realized/unrealized):						
Included in earnings:						
Realized investment gains (losses), net	0	0	(6)	6	0	0
Included in other comprehensive income (loss)	0	0	(10)	(34)	(8)	(1)
Net investment income	0	0	2	5	(3)	0
Purchases	66	0	11	234	0	1
Sales	0	0	(24)	(80)	(4)	(1)
Issuances	0	0	28	0	0	0
Settlements	0	0	(40)	(100)	(3)	1
Foreign currency translation	0	0	7	48	6	0
Transfers into Level 3(1)	0	0	49	17	5	0
Transfers out of Level 3(1)	0	0	(87)	(298)	(5)	0
Fair Value, end of period	$ 66	$ 27	$ 1,208	$ 2,731	$ 93	$ 20
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2):						
Included in earnings:						
Realized investment gains (losses), net	$ 0	$ 0	$ (3)	$ 2	$ 1	$ 0

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Three Months Ended September 30, 2011				
	Trading Account Assets Supporting Insurance Liabilities-U.S. Government Authorities	Trading Account Assets Supporting Insurance Liabilities-Corporate Securities	Trading Account Assets Supporting Insurance Liabilities-Asset-Backed Securities	Trading Account Assets Supporting Insurance Liabilities-Commercial Mortgage-Backed Securities	Trading Account Assets Supporting Insurance Liabilities-Residential Mortgage-Backed Securities
			(in millions)		
Fair Value, beginning of period	$ 0	$ 84	$ 410	$ 14	$ 2
Total gains (losses) (realized/unrealized):					
Included in earnings:					
Asset management fees and other income	0	(1)	(4)	0	0
Net investment income	0	0	1	0	0
Purchases	9	0	16	0	0
Sales	0	0	0	0	0
Issuances	0	0	0	0	0
Settlements	0	(4)	(35)	0	0
Transfers into Level 3(1)	0	15	0	0	0
Transfers out of Level 3(1)	0	(2)	(38)	(10)	0
Fair Value, end of period	$ 9	$ 92	$ 350	$ 4	$ 2
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2):					
Included in earnings:					
Asset management fees and other income	$ 0	$ (2)	$ (4)	$ 0	$ 0

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Three Months Ended September 30, 2011				
	Trading Account Assets Supporting Insurance Liabilities- Equity Securities	Other Trading Account Assets- Corporate Securities	Other Trading Account Assets - Asset- Backed Securities	Other Trading Account Assets- Commercial Mortgage- Backed Securities	Other Trading Account Assets- Residential Mortgage- Backed Securities
			(in millions)		
Fair Value, beginning of period	$ 58	$ 40	$ 77	$ 18	$ 15
Total gains (losses) (realized/unrealized):					
Included in earnings:					
Asset management fees and other income	(7)	2	(7)	(1)	(3)
Net investment income	0	0	1	0	(1)
Purchases	1	1	0	0	0
Sales	(2)	(3)	(6)	(6)	4
Issuances	0	0	0	0	0
Settlements	0	0	(2)	0	0
Foreign currency translation	1	0	4	2	1
Other(4)	0	(1)	1	14	(14)
Transfers into Level 3(1)	0	0	0	3	(1)
Transfers out of Level 3(1)	0	0	(1)	(1)	1
Fair Value, end of period	$ 51	$ 39	$ 67	$ 29	$ 2
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2):					
Included in earnings:					
Asset management fees and other income	$ (7)	$ 1	$ (7)	$ (4)	$ 0

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Three Months Ended September 30, 2011				
	Other Trading Account Assets-Equity Securities	Other Trading Account Assets-All Other Activity	Equity Securities Available for Sale (in millions)	Commercial Mortgage and Other Loans	Other Long-term Investments
Fair Value, beginning of period	$ 165	$ 94	$ 1,661	$ 144	$ 1,230
Total gains (losses) (realized/unrealized):					
Included in earnings:					
Realized investment gains (losses), net	0	74	(2)	9	1
Asset management fees and other income	(67)	0	0	0	(12)
Included in other comprehensive income (loss)	0	0	14	0	0
Net investment income	0	0	0	0	(11)
Purchases	5	0	4	0	103
Sales	(28)	0	5	0	(1)
Issuances	0	0	0	0	0
Settlements	(13)	(7)	(40)	(57)	(1)
Foreign currency translation	33	0	50	0	9
Other(4)	1,277	0	(1,280)	0	0
Transfers into Level 3(1)	0	0	(2)	0	0
Transfers out of Level 3(1)	0	0	2	0	0
Fair Value, end of period	$ 1,372	$ 161	$ 412	$ 96	$ 1,318
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2):					
Included in earnings:					
Realized investment gains (losses), net	$ 0	$ 74	$ (3)	$ 8	$ 0
Asset management fees and other income	$ (73)	$ 1	$ 0	$ 0	$ (20)

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Three Months Ended September 30, 2011			
	Other Assets	Separate Account Assets(3)	Future Policy Benefits	Other Liabilities
		(in millions)		
Fair Value, beginning of period	$ 9	$ 17,536	$ 423	$ (2)
Total gains (losses) (realized/unrealized):				
Included in earnings:				
Realized investment gains (losses), net	0	0	(3,310)	0
Interest credited to policyholders’ account balances	0	699	0	0
Purchases	0	319	0	0
Sales	0	(925)	0	0
Issuances	0	1	(130)	0
Settlements	0	393	(1)	(1)
Transfers into Level 3(1)	0	15	0	0
Transfers out of Level 3(1)	0	(188)	0	0
Fair Value, end of period	$ 9	$ 17,850	$ (3,018)	$ (3)
Unrealized gains (losses) for the period relating to those Level 3 assets and liabilities that were still held at the end of the period(2):				
Included in earnings:				
Realized investment gains (losses), net	$ 0	$ 0	$ (3,312)	$ (1)
Interest credited to policyholders’ account balances	$ 0	$ 452	$ 0	$ 0

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Nine Months Ended September 30, 2011					
	Fixed Maturities Available For Sale - U.S. Government Authorities	Fixed Maturities Available For Sale - Foreign Government Bonds	Fixed Maturities Available For Sale - Corporate Securities	Fixed Maturities Available For Sale - Asset-Backed Securities	Fixed Maturities Available For Sale - Commercial Mortgage-Backed Securities	Fixed Maturities Available For Sale - Residential Mortgage-Backed Securities
	(in millions)					
Fair Value, beginning of period	$ 0	$ 27	$ 1,187	$ 1,753	$ 130	$ 23
Total gains (losses) (realized/unrealized):						
Included in earnings:						
Realized investment gains (losses), net	0	0	(33)	32	(35)	0
Included in other comprehensive income (loss)	0	0	(12)	0	7	(1)
Net investment income	0	0	8	20	2	0
Purchases	66	0	435	1,239	5	1
Sales	0	0	(89)	(413)	(20)	(1)
Issuances	0	0	32	0	0	0
Settlements	0	0	(278)	(237)	(36)	(1)
Foreign currency translation	0	0	10	64	9	0
Other(4)	0	0	146	502	31	(1)
Transfers into Level 3(1)	0	0	234	250	5	0
Transfers out of Level 3(1)	0	0	(432)	(479)	(5)	0
Fair Value, end of period	$ 66	$ 27	$ 1,208	$ 2,731	$ 93	$ 20
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2):						
Included in earnings:						
Realized investment gains (losses), net	$ 0	$ 0	$ (39)	$ 6	$ (40)	$ 0

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Nine Months Ended September 30, 2011				
	Trading Account Assets Supporting Insurance Liabilities-U.S. Government Authorities	Trading Account Assets Supporting Insurance Liabilities-Corporate Securities	Trading Account Assets Supporting Insurance Liabilities-Asset-Backed Securities	Trading Account Assets Supporting Insurance Liabilities-Commercial Mortgage-Backed Securities	Trading Account Assets Supporting Insurance Liabilities-Residential Mortgage-Backed Securities
	(in millions)				
Fair Value, beginning of period	$ 0	$ 82	$ 226	$ 5	$ 18
Total gains (losses) (realized/unrealized):					
Included in earnings:					
Asset management fees and other income	0	(2)	0	0	0
Net investment income	0	0	3	0	0
Purchases	9	49	269	10	0
Sales	0	(11)	(23)	0	0
Issuances	0	1	0	0	0
Settlements	0	(35)	(82)	(1)	(1)
Other(4)	0	0	15	0	(15)
Transfers into Level 3(1)	0	25	0	0	0
Transfers out of Level 3(1)	0	(17)	(58)	(10)	0
Fair Value, end of period	$ 9	$ 92	$ 350	$ 4	$ 2
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2):					
Included in earnings:					
Asset management fees and other income	$ 0	$ (2)	$ 0	$ 0	$ 0

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Nine Months Ended September 30, 2011				
	Trading Account Assets Supporting Insurance Liabilities-Equity Securities	Other Trading Account Assets-Corporate Securities	Other Trading Account Assets-Asset-Backed Securities (in millions)	Other Trading Account Assets-Commercial Mortgage-Backed Securities	Other Trading Account Assets-Residential Mortgage-Backed Securities
Fair Value, beginning of period	$ 4	$ 35	$ 54	$ 19	$ 18
Total gains (losses) (realized/unrealized):					
Included in earnings:					
Asset management fees and other income	(6)	2	0	4	0
Net investment income	0	0	2	1	0
Purchases	5	9	0	0	0
Sales	(29)	(7)	(16)	(12)	(2)
Issuances	0	0	0	0	0
Settlements	0	0	(8)	(2)	(1)
Foreign currency translation	1	0	6	2	1
Other(4)	0	(1)	1	14	(14)
Transfers into Level 3(1)	76	1	39	5	0
Transfers out of Level 3(1)	0	0	(11)	(2)	0
Fair Value, end of period	$ 51	$ 39	$ 67	$ 29	$ 2
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2):					
Included in earnings:					
Asset management fees and other income	$ (6)	$ 2	$ (3)	$ 0	$ 0

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Nine Months Ended September 30, 2011				
	Other Trading Account Assets-Equity Securities	Other Trading Account Assets-All Other Activity	Equity Securities Available for Sale (in millions)	Commercial Mortgage and Other Loans	Other Long-term Investments
Fair Value, beginning of period	$ 26	$ 134	$ 355	$ 212	$ 768
Total gains (losses) (realized/unrealized):					
Included in earnings:					
Realized investment gains (losses), net	0	37	(17)	15	5
Asset management fees and other income	(54)	4	0	0	55
Included in other comprehensive income (loss)	0	0	42	0	0
Net investment income	0	0	0	0	(10)
Purchases	6	0	45	0	236
Sales	(30)	0	(40)	0	(7)
Issuances	0	0	0	0	0
Settlements	(15)	(14)	(41)	(131)	(8)
Foreign currency translation	36	0	79	0	12
Other(4)	1,277	0	(831)	0	267
Transfers into Level 3(1)	126	0	822	0	0
Transfers out of Level 3(1)	0	0	(2)	0	0
Fair Value, end of period	$ 1,372	$ 161	$ 412	$ 96	$ 1,318
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2):					
Included in earnings:					
Realized investment gains (losses), net	$ 0	$ 37	$ (25)	$ 15	$ 2
Asset management fees and other income	$ (59)	$ 4	$ 0	$ 0	$ 16

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Nine Months Ended September 30, 2011			
	Other Assets	Separate Account Assets(3)	Future Policy Benefits	Other Liabilities
	(in millions)			
Fair Value, beginning of period	$ 9	$ 15,792	$ 204	$ (3)
Total gains (losses) (realized/unrealized):				
Included in earnings:				
Realized investment gains (losses), net	0	0	(2,854)	(7)
Interest credited to policyholders’ account balances	0	2,334	0	0
Purchases	0	2,121	0	0
Sales	0	(1,062)	0	0
Issuances	0	3	(366)	0
Settlements	0	(861)	(2)	7
Transfers into Level 3(1)	0	161	0	0
Transfers out of Level 3(1)	0	(638)	0	0
Fair Value, end of period	$ 9	$ 17,850	$ (3,018)	$ (3)
Unrealized gains (losses) for the period relating to those Level 3 assets and liabilities that were still held at the end of the period(2):				
Included in earnings:				
Realized investment gains (losses), net	$ 0	$ 0	$ (2,864)	$ (8)
Interest credited to policyholders’ account balances	$ 0	$ 1,605	$ 0	$ 0

(1) Transfers into or out of Level 3 are generally reported as the value as of the beginning of the quarter in which the transfer occurs.
(2) Unrealized gains or losses related to assets still held at the end of the period do not include amortization or accretion of premiums and discounts.
(3) Separate account assets represent segregated funds that are invested for certain customers. Investment risks associated with market value changes are borne by the customers, except to the extent of minimum guarantees made by the Company with respect to certain accounts. Separate account liabilities are not included in the above table as they are reported at contract value and not fair value in the Company’s Unaudited Interim Consolidated Statement of Financial Position.
(4) For the nine months ended September 30, 2011, Other primarily represents reclasses of certain assets between reporting categories and assets acquired through the Star and Edison acquisition. For all other periods, Other primarily represents reclasses of certain assets between reporting categories.

Transfers—Transfers into Level 3 are generally the result of unobservable inputs utilized within valuation methodologies and the use of broker quotes (that cannot be validated) for which information from third party pricing services (that can be validated) was previously utilized. Transfers out of Level 3 are generally due to the use of observable inputs in valuation methodologies as well as the utilization of pricing service information for certain assets that the Company is able to validate. Significant transfers into and/or out of Level 3 are discussed below:

For the nine months ended September 30, 2012, the majority of the Equity Securities Available-for-Sale transfers out of Level 3 were due to the determination that the pricing inputs for certain equity securities did not have a material liquidity discount and therefore, should be classified as Level 1, not Level 3. For the nine months ended September 30, 2011, the majority of the Equity Securities Available for Sale, Trading Account Assets Supporting Insurance Liabilities—Equity Securities and Other Trading Account Assets—Equity Securities transfers into Level 3 were due to the determination that the pricing inputs for perpetual preferred stocks provided by third party pricing services were primarily based on indicative broker quotes which could not always be verified against directly observable market information.

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Derivative Fair Value Information

The following tables present the balance of derivative assets and liabilities measured at fair value on a recurring basis, as of the date indicated, by primary underlying. These tables exclude embedded derivatives which are recorded with the associated host contract. The derivative assets and liabilities shown below are included in “Other trading account assets,” “Other long-term investments” or “Other liabilities” in the tables presented previously in this note, under the headings “Assets and Liabilities by Hierarchy Level” and “Changes in Level 3 Assets and Liabilities.”

	As of September 30, 2012				
	Level 1	Level 2	Level 3	Netting(1)	Total
			(in millions)		
Derivative assets:					
Interest Rate	$ 4	$ 13,367	$ 10	$	$ 13,381
Currency	0	123	0		123
Credit	0	20	0		20
Currency/Interest Rate	0	536	0		536
Equity	388	633	26		1,047
Netting(1)				(11,537)	(11,537)
Total derivative assets	$ 392	$ 14,679	$ 36	$ (11,537)	$ 3,570
Derivative liabilities:					
Interest Rate	$ 2	$ 7,233	$ 3	$	$ 7,238
Currency	0	207	0		207
Credit	0	99	0		99
Currency/Interest Rate	0	781	0		781
Equity	0	221	0		221
Netting(1)				(8,290)	(8,290)
Total derivative liabilities	$ 2	$ 8,541	$ 3	$ (8,290)	$ 256

	As of December 31, 2011				
	Level 1	Level 2	Level 3	Netting(1)	Total
			(in millions)		
Derivative assets:					
Interest Rate	$ 10	$ 12,383	$ 5	$	$ 12,398
Currency	0	219	0		219
Credit	0	56	1		57
Currency/Interest Rate	0	562	0		562
Equity	149	365	83		597
Netting(1)				(11,222)	(11,222)

Total derivative assets	$ 159	$ 13,585	$ 89	$ (11,222)	$ 2,611
Derivative liabilities:					
Interest Rate	$ 9	$ 6,587	$ 6	$	$ 6,602
Currency	0	297	0		297
Credit	0	130	0		130
Currency/Interest Rate	0	928	0		928
Equity	0	246	0		246
Netting(1)				(7,854)	(7,854)
Total derivative liabilities	$ 9	$ 8,188	$ 6	$ (7,854)	$ 349

(1) “Netting” amounts represent cash collateral and the impact of offsetting asset and liability positions held with the same counterparty.

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Changes in Level 3 derivative assets and liabilities—The following tables provide a summary of the changes in fair value of Level 3 derivative assets and liabilities, as well as the portion of gains or losses included in income, attributable to unrealized gains or losses related to those assets and liabilities still held at the end of the reporting period.

	Three Months Ended September 30, 2012			Nine Months Ended September 30, 2012		
	Derivative Assets-Equity	Derivative Assets-Credit	Derivative Assets-Interest Rate	Derivative Assets-Equity	Derivative Assets-Credit	Derivative Assets-Interest Rate
			(in millions)			
Fair Value, beginning of period	$ 40	$ 0	$ 2	$ 83	$ 1	$ (1)
Total gains (losses) (realized/unrealized):						
Included in earnings:						
Realized investment gains (losses), net	(15)	0	5	(63)	(1)	8
Asset management fees and other income	0	0	0	0	0	0
Purchases	1	0	0	6	0	0
Sales	0	0	0	0	0	0
Issuances	0	0	0	0	0	0
Settlements	0	0	0	0	0	0
Transfers into Level 3(1)	0	0	0	0	0	0
Transfers out of Level 3(1)	0	0	0	0	0	0
Fair Value, end of period	$ 26	$ 0	$ 7	$ 26	$ 0	$ 7
Unrealized gains (losses) for the period relating to those level 3 assets that were still held at the end of the period:						
Included in earnings:						
Realized investment gains (losses), net	$ (15)	$ 0	$ 5	$ (63)	$ (1)	$ 8
Asset management fees and other income	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Three Months Ended September 30, 2011			Nine Months Ended September 30, 2011		
	Derivative Assets-Equity	Derivative Assets-Credit	Derivative Liabilities-Interest Rate	Derivative Assets-Equity	Derivative Assets-Credit	Derivative Liabilities-Interest Rate
	(in millions)					
Fair Value, beginning of period	$ 82	$ 2	$ (7)	$ 127	$ 0	$ (12)
Total gains (losses) (realized/unrealized):						
Included in earnings:						
Realized investment gains (losses), net	75	1	0	34	3	5
Asset management fees and other income	0	0	0	0	0	0
Purchases	0	0	0	0	0	0
Sales	0	0	0	0	0	0
Issuances	0	0	0	0	0	0
Settlements	(7)	0	0	(11)	0	0
Transfers into Level 3(1)	0	0	0	0	0	0
Transfers out of Level 3(1)	0	0	0	0	0	0
Fair Value, end of period	$ 150	$ 3	$ (7)	$ 150	$ 3	$ (7)
Unrealized gains (losses) for the period relating to those level 3 assets that were still held at the end of the period:						
Included in earnings:						
Realized investment gains (losses), net	$ 75	$ 1	$ 0	$ 34	$ 3	$ 5
Asset management fees and other income	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0

(1) Transfers into or out of Level 3 are generally reported as the value as of the beginning of the quarter in which the transfer occurs.

Nonrecurring Fair Value Measurements—Certain assets and liabilities are measured at fair value on a nonrecurring basis. Nonrecurring fair value reserve adjustments resulted in $0 million and $2 million of net gains being recorded for the three and nine months ended September 30, 2012, respectively on certain commercial mortgage loans. The carrying value of these loans as of September 30, 2012 was $62 million. Similar commercial mortgage loan reserve adjustments of $1 million and $4 million in net gains were recorded for the three and nine months ended September 30, 2011, respectively. The reserve adjustments were based on discounted cash flows utilizing market rates and were classified as Level 3 in the hierarchy.

Impairments of $20 million and $4 million were recorded for the three months ended September 30, 2012 and 2011, respectively, and $91 million and $18 million for the nine months ended September 30, 2012 and 2011, respectively, for real estate and property and equipment related investments. These impairments were based primarily on appraised value. All impairments were classified as Level 3 in the valuation hierarchy. Impairments of $1 million and $4 million were recorded for the three months ended September 30, 2012 and 2011, respectively, and $3 million and $5 million for the nine months ended September 30, 2012 and 2011, respectively, on certain cost method investments. These fair value adjustments were based on inputs classified as Level 3 in the valuation hierarchy. The methodologies utilized were primarily discounted estimated future cash flows and, where appropriate, valuations provided by the general partners taking into consideration deal and management fee expenses. Impairments of $5 million and $4 million were recorded for the three months ended

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September 30, 2012 and 2011 respectively, and $12 million and $8 million for the nine months ended September 30, 2012 and 2011, respectively on mortgage servicing rights. These were based on internal models and classified as Level 3 in the hierarchy.

An impairment of $29 million was recorded for the three and nine months ended September 30, 2012 related to the write-off of an intangible asset related to an acquired business. The method utilized was primarily discounted cash flows based on assumptions and inputs specific to the Company, and are therefore classified as Level 3 in the hierarchy.

Fair Value Option—The following table presents information regarding changes in fair values recorded in earnings for commercial mortgage loans, other long-term investments and other liabilities where the fair value option has been elected.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Assets:				
Commercial mortgage loans:				
Changes in instrument-specific credit risk	$ 0	$ (1)	$ (1)	$ (2)
Other changes in fair value	$ 0	$ 1	$ 0	$ 4
Other long-term investments:				
Changes in fair value	$ 18	$ (16)	$ 30	$ (12)
Liabilities:				
Other Liabilities:				
Changes in fair value	$ 2	$ 0	$ (1)	$ 0

Changes in fair value are reflected in “Realized investment gains (losses), net” for commercial mortgage loans and “Asset management fees and other income” for other long-term investments and other liabilities. Changes in fair value due to instrument-specific credit risk are estimated based on changes in credit spreads and quality ratings for the period reported.

Interest income on commercial mortgage loans is included in net investment income. The Company recorded $4 million and $2 million for the three months ended September 30, 2012 and 2011, respectively, and $9 million and $9 million for the nine months ended September 30, 2012 and 2011, respectively, of interest income on fair value option loans. Interest income on these loans is recorded based on the effective interest rates as determined at the closing of the loan.

The fair values and aggregate contractual principal amounts of commercial mortgage loans, for which the fair value option has been elected, were $248 million and $246 million, respectively, as of September 30, 2012, and $603 million and $598 million, respectively, as of December 31, 2011. As of September 30, 2012, loans that were in nonaccrual status had fair values of $20 million and aggregate contractual principal amounts of $23 million, respectively.

The fair value of other long-term investments was $462 million as of September 30, 2012 and $366 million as of December 31, 2011.

The fair value and aggregate contractual principal amounts of other liabilities, for which the fair value option has been elected, were $394 million and $391 million, respectively, as of September 30, 2012, and $282 million and $294 million, respectively as of December 31, 2011. Interest expense recorded for these liabilities was $2 million and $8 million, respectively, for the three and nine months ended September 30, 2012.

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Fair Value of Financial Instruments

The table below presents the carrying amount and fair value by fair value hierarchy level of certain financial instruments that are not reported at fair value. However, in some cases, as described below, the carrying amount equals or approximates fair value.

	September 30, 2012					December 31, 2011	
	Fair Value				Carrying Amount(1)	Fair Value	Carrying Amount
	Level 1	Level 2	Level 3	Total	Total	Total	Total
				(in millions)			
Assets:							
Fixed maturities, held-to-maturity	$ 0	$ 3,144	$ 1,875	$ 5,019	$ 4,720	$ 5,354	$ 5,107
Commercial mortgage and other loans	0	798	38,957	39,755	36,574	37,138	34,831
Policy loans	0	0	14,724	14,724	11,701	14,858	11,559
Short-term investments	0	51	0	51	51	356	356
Cash and cash equivalents	3,623	916	0	4,539	4,539	4,822	4,822
Accrued investment income	0	2,870	0	2,870	2,870	2,793	2,793
Other assets	56	1,893	682	2,631	2,631	3,105	3,105
Total assets	$ 3,679	$ 9,672	$ 56,238	$ 69,589	$ 63,086	$ 68,426	$ 62,573
Liabilities:							
Policyholders’ account balances-investment contracts	$ 0	$ 41,770	$ 63,525	$ 105,295	$ 102,293	$ 103,184	$ 102,245
Securities sold under agreements to repurchase	0	8,033	0	8,033	8,033	6,218	6,218
Cash collateral for loaned securities	0	3,376	0	3,376	3,376	2,973	2,973
Short-term debt	0	3,044	0	3,044	3,013	2,346	2,336
Long-term debt	961	20,838	4,597	26,396	23,845	25,828	24,622
Bank customer liabilities(2)	0	0	0	0	0	1,745	1,730
Other liabilities	0	4,723	914	5,637	5,670	5,876	5,907
Separate account liabilities-investment contracts	0	75,295	20,618	95,913	95,913	89,492	89,492
Total liabilities	$ 961	$ 157,079	$ 89,654	$ 247,694	$ 242,143	$ 237,662	$ 235,523

(1) Carrying values presented herein differ from those in the Company’s Unaudited Interim Consolidated Statement of Financial Position because certain items within the respective financial statement captions are not considered financial instruments or out of scope under authoritative guidance relating to disclosures of the fair value of financial instruments. Financial statement captions excluded from the above table are not considered financial instruments.
(2) Amount included in “Other liabilities” in the Company’s Unaudited Interim Consolidated Statement of Financial Position.

The fair values presented above have been determined by using available market information and by applying market valuation methodologies, as described in more detail below.

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Fixed Maturities, Held-to-Maturity

The fair values of public fixed maturity securities are generally based on prices from third-party pricing services, which are reviewed to validate reasonableness. However, for certain public fixed maturity securities and investments in private placement fixed maturity securities, this information is either not available or not reliable. For these public fixed maturity securities, the fair value is based on indicative broker quotes, if available, or determined using a discounted cash flow model or internally-developed values. For private fixed maturities fair value is determined using a discounted cash flow model. In determining the fair value of certain fixed maturity securities, the discounted cash flow model may also use unobservable inputs, which reflect the Company’s own assumptions about the inputs market participants would use in pricing the security.

Commercial Mortgage and Other Loans

The fair value of most commercial mortgage loans is based upon the present value of the expected future cash flows discounted at the appropriate U.S. Treasury rate or foreign government bond rate (for non-U.S. dollar-denominated loans) plus an appropriate credit spread for similar quality loans. The quality ratings for these loans, a primary determinant of the credit spreads and a significant component of the pricing process, are based on an internally-developed methodology.

Certain commercial mortgage loans are valued incorporating other factors, including the terms of the loans, the principal exit strategies for the loans, prevailing interest rates and credit risk. Other loan valuations are primarily based upon the present value of the expected future cash flows discounted at the appropriate Japanese government bond rate and local market swap rates or credit default swap spreads, plus an appropriate credit spread and liquidity premium. The credit spread and liquidity premium are a significant component of the pricing inputs, and are based upon an internally-developed methodology, which takes into account, among other factors, the credit quality of the loans, the property type of the collateral, the weighted average coupon and the weighted average life of the loans.

Policy Loans

The fair value of U.S. insurance policy loans is calculated using a discounted cash flow model based upon current U.S. Treasury rates and historical loan repayment patterns, while Japanese insurance policy loans use the risk-free proxy based on the yen LIBOR. For group corporate-, bank- and trust-owned life insurance contracts and group universal life contracts, the fair value of the policy loans is the amount due, excluding interest, as of the reporting date.

Short-Term Investments, Cash & Equivalents, Accrued Investment Income and Other Assets

The Company believes that due to the short-term nature of certain assets, the carrying value approximates fair value. These assets include: certain short-term investments which are not securities, are recorded at amortized cost and include quality loans; cash and cash equivalent instruments; accrued investment income; and other assets that meet the definition of financial instruments, including receivables, such as reinsurance recoverables, unsettled trades, accounts receivable and restricted cash.

Policyholders’ Account Balances—Investment Contracts

Only the portion of policyholders’ account balances related to products that are investment contracts (those without significant mortality or morbidity risk) are reflected in the table above. For fixed deferred annuities, single premium endowments, payout annuities and other similar contracts without life contingencies, fair values

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

are derived using discounted projected cash flows based on interest rates that are representative of the Company’s financial strength ratings, and hence reflect the Company’s own non-performance risk. For guaranteed investment contracts, funding agreements, structured settlements without life contingencies and other similar products, fair values are derived using discounted projected cash flows based on interest rates being offered for similar contracts with maturities consistent with those of the contracts being valued. For those balances that can be withdrawn by the customer at any time without prior notice or penalty, the fair value is the amount estimated to be payable to the customer as of the reporting date, which is generally the carrying value. For defined contribution and defined benefit contracts and certain other products, the fair value is the market value of the assets supporting the liabilities.

Securities Sold Under Agreements to Repurchase

The Company receives collateral for selling securities under agreements to repurchase, or pledges collateral under agreements to resell. Repurchase and resale agreements are also generally short-term in nature, and therefore, the carrying amounts of these instruments approximate fair value.

Cash Collateral for Loaned Securities

Cash collateral for loaned securities represents the collateral received or paid in connection with loaning or borrowing securities, similar to the securities sold under agreement to repurchase above. For these transactions, the carrying value of the related asset or liability approximates fair value, as they equal the amount of cash collateral received/paid.

Debt

The fair value of short-term and long-term debt, as well as debt of consolidated VIEs, is generally determined by either prices obtained from independent pricing services, which are validated by the Company, or discounted cash flow models. With the exception of the debt of consolidated VIEs which is non-recourse to the Company, these fair values consider the Company’s own non-performance risk. Discounted cash flow models predominately use market observable inputs such as the borrowing rates currently available to the Company for debt and financial instruments with similar terms and remaining maturities. For commercial paper issuances and other debt with a maturity of less than 90 days, the carrying value approximates fair value. Debt of consolidated VIEs is reflected within “Other liabilities.”

A portion of the senior secured notes issued by Prudential Holdings, LLC (the “IHC debt”) is insured by a third-party financial guarantee insurance policy. The effect of the third-party credit enhancement is not included in the fair value measurement of the IHC debt and the methodologies used to determine fair value consider the Company’s own non-performance risk.

Bank Customer Liabilities

The carrying amount for certain deposits (interest and non-interest demand, savings and money market accounts) approximates or equals their fair values. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates being offered on certificates at the reporting dates to a schedule of aggregated expected monthly maturities. Bank customer liabilities are reflected within “Other liabilities.” During 2012, the Company divested bank customer liabilities as part of a previously announced decision to limit banking operations to trust services.

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Other Liabilities

Other liabilities are primarily payables, such as reinsurance payables, unsettled trades, drafts and accrued expense payables. Due to the short term until settlement of most of these liabilities, the Company believes that carrying value approximates fair value.

Separate Account Liabilities—Investment Contracts

Only the portion of separate account liabilities related to products that are investments contracts are reflected in the table above. Separate account liabilities are recorded at the amount credited to the contractholder, which reflects the change in fair value of the corresponding separate account assets including contractholder deposits less withdrawals and fees. Therefore, carrying value approximates fair value.

14. DERIVATIVE INSTRUMENTS

Types of Derivative Instruments and Derivative Strategies used in a non-dealer or broker capacity

Interest Rate Contracts

Interest rate swaps and exchange-traded futures and options are used by the Company to reduce risks from changes in interest rates, manage interest rate exposures arising from mismatches between assets and liabilities (including duration mismatches) and to hedge against changes in the value of assets it owns or anticipates acquiring or selling. Swaps may be attributed to specific assets or liabilities or may be used on a portfolio basis. Under interest rate swaps, the Company agrees with other parties to exchange, at specified intervals, the difference between fixed-rate and floating-rate interest amounts calculated by reference to an agreed upon notional principal amount. Generally, no cash is exchanged at the outset of the contract and no principal payments are made by either party. These transactions are entered into pursuant to master agreements that provide for a single net payment to be made by one counterparty at each due date.

In exchange-traded futures transactions, the Company agrees to purchase or sell a specified number of contracts, the values of which are determined by the values of underlying referenced investments, and to post variation margin on a daily basis in an amount equal to the difference in the daily market values of those contracts. The Company enters into exchange-traded futures and options with regulated futures commission’s merchants who are members of a trading exchange.

Equity Contracts

Equity index options are contracts which will settle in cash based on differentials in the underlying indices at the time of exercise and the strike price. The Company uses combinations of purchases and sales of equity index options to hedge the effects of adverse changes in equity indices within a predetermined range. These hedges do not qualify for hedge accounting.

Foreign Exchange Contracts

Currency derivatives, including exchange-traded currency futures and options, currency forwards and currency swaps, are used by the Company to reduce risks from changes in currency exchange rates with respect to investments denominated in foreign currencies that the Company either holds or intends to acquire or sell, and to hedge the currency risk associated with net investments in foreign operations and anticipated earnings of its foreign operations.

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Under currency forwards, the Company agrees with other parties to deliver a specified amount of an identified currency at a specified future date. Typically, the price is agreed upon at the time of the contract and payment for such a contract is made at the specified future date. As noted above, the Company uses currency forwards to mitigate the impact of changes in currency exchange rates on U.S. dollar equivalent earnings generated by certain of its non-U.S. businesses, primarily its international insurance and investments operations. The Company executes forward sales of the hedged currency in exchange for U.S. dollars at a specified exchange rate. The maturities of these forwards correspond with the future periods in which the non-U.S. dollar-denominated earnings are expected to be generated. These earnings hedges do not qualify for hedge accounting.

Under currency swaps, the Company agrees with other parties to exchange, at specified intervals, the difference between one currency and another at an exchange rate and calculated by reference to an agreed principal amount. Generally, the principal amount of each currency is exchanged at the beginning and termination of the currency swap by each party. These transactions are entered into pursuant to master agreements that provide for a single net payment to be made by one counterparty for payments made in the same currency at each due date.

Credit Contracts

Credit derivatives are used by the Company to enhance the return on the Company’s investment portfolio by creating credit exposure similar to an investment in public fixed maturity cash instruments. With credit derivatives the Company sells credit protection on an identified name, or a basket of names in a first to default structure, and in return receives a quarterly premium. With single name credit default derivatives, this premium or credit spread generally corresponds to the difference between the yield on the referenced name’s public fixed maturity cash instruments and swap rates, at the time the agreement is executed. With first to default baskets, the premium generally corresponds to a high proportion of the sum of the credit spreads of the names in the basket. If there is an event of default by the referenced name or one of the referenced names in a basket, as defined by the agreement, then the Company is obligated to pay the counterparty the referenced amount of the contract and receive in return the referenced defaulted security or similar security. See credit derivatives written section for discussion of guarantees related to credit derivatives written. In addition to selling credit protection the Company has purchased credit protection using credit derivatives in order to hedge specific credit exposures in the Company’s investment portfolio.

Other Contracts

TBAs. The Company uses “to be announced” (“TBA”) forward contracts to gain exposure to the investment risk and return of mortgage-backed securities. TBA transactions can help the Company enhance the return on its investment portfolio. TBAs can provide a more liquid and cost effective method of achieving these goals than purchasing or selling individual mortgage-backed pools. Typically, the price is agreed upon at the time of the contract and payment for such a contract is made at a specified future date. Additionally, pursuant to the Company’s mortgage dollar roll program, TBAs or mortgage-backed securities are transferred to counterparties with a corresponding agreement to repurchase them at a future date. These transactions do not qualify as secured borrowings and are accounted for as derivatives.

Loan Commitments. In its mortgage operations, the Company enters into commitments to fund commercial mortgage loans at specified interest rates and other applicable terms within specified periods of time. These commitments are legally binding agreements to extend credit to a counterparty. Loan commitments for loans that will be held for sale are recognized as derivatives and recorded at fair value. The determination of the fair value of loan commitments accounted for as derivatives considers various factors including, among others, terms of the related loan, the intended exit strategy for the loans based upon either securitization valuation models or investor

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purchase commitments, prevailing interest rates, origination income or expense, and the value of service rights. Loan commitments that relate to the origination of mortgage loans that will be held for investment are not accounted for as derivatives and accordingly are not recognized in the Company’s financial statements. See Note 15 for a further discussion of these loan commitments.

Embedded Derivatives. The Company sells variable annuity products, which may include guaranteed benefit features that are accounted for as embedded derivatives. These embedded derivatives are marked to market through “Realized investment gains (losses), net” based on the change in value of the underlying contractual guarantees, which are determined using valuation models. The Company maintains a portfolio of derivative instruments that is intended to economically hedge the risks related to the above products’ features. The derivatives may include, but are not limited to equity options, total return swaps, interest rate swap options, caps, floors, and other instruments. In addition, some variable annuity products feature an automatic rebalancing element, also referred to as an asset transfer feature, to minimize risks inherent in the Company’s guarantees which reduces the need for derivatives.

The Company invests in fixed maturities that, in addition to a stated coupon, provide a return based upon the results of an underlying portfolio of fixed income investments and related investment activity. The Company accounts for these investments as available-for-sale fixed maturities containing embedded derivatives. Such embedded derivatives are marked to market through “Realized investment gains (losses), net,” based upon the change in value of the underlying portfolio.

Synthetic Guarantees. The Company sells fee-based synthetic guaranteed investment contracts, which include investment-only, stable value contracts, to qualified pension plans. The assets are owned by the trustees of such plans, who invest the assets under the terms of investment guidelines agreed to with the Company. The contracts contain a guarantee of a minimum rate of return on participant balances supported by the underlying assets, and a guarantee of liquidity to meet certain participant-initiated plan cash flow requirements. These contracts are accounted for as derivatives, recorded at fair value and classified as interest rate derivatives.

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The table below provides a summary of the gross notional amount and fair value of derivatives contracts used in a non-dealer or broker capacity, excluding embedded derivatives which are recorded with the associated host, by the primary underlying. Many derivative instruments contain multiple underlyings. 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 and cash collateral held with the same counterparty. This netting impact results in total derivative assets of $3,570 million and $2,611 million as of September 30, 2012 and December 31, 2011, respectively, and total derivative liabilities of $256 million and $349 million as of September 30, 2012 and December 31, 2011, respectively, reflected in the Unaudited Interim Consolidated Statement of Financial Position.

	September 30, 2012			December 31, 2011		
	Notional	Fair Value		Notional	Fair Value	
Primary Underlying/ Instrument Type	Amount	Assets	Liabilities	Amount	Assets	Liabilities
			(in millions)			
Qualifying Hedges:						
Interest Rate						
Interest Rate Swaps	$ 3,438	$ 29	$ (450)	$ 5,048	$ 62	$ (468)
Foreign Currency						
Foreign Currency Forwards	902	10	(16)	753	6	(4)
Currency/Interest Rate						
Foreign Currency Swaps	6,098	214	(417)	4,807	227	(438)
Total Qualifying Hedges	$ 10,438	$ 253	$ (883)	$ 10,608	$ 295	$ (910)
Non-Qualifying Hedges:						
Interest Rate						
Interest Rate Swaps	$ 132,018	$ 10,117	$ (3,478)	$ 107,560	$ 9,357	$ (3,084)
Interest Rate Futures	7,402	5	(2)	6,192	10	(9)
Interest Rate Options	538	9	(1)	601	13	(3)
Interest Rate Forwards	810	6	0	2,139	6	0
Synthetic GICs	61,657	10	0	46,844	4	0
Foreign Currency						
Foreign Currency Forwards	14,623	99	(179)	16,228	176	(335)
Foreign Currency Options	97	18	0	98	23	0
Currency/Interest Rate						
Foreign Currency Swaps	5,181	226	(293)	5,390	224	(399)
Credit						
Credit Default Swaps	2,549	22	(99)	3,298	58	(130)
Equity						
Equity Futures	7,421	388	0	2,114	149	0
Equity Options	41,434	640	(56)	14,951	415	(66)
Total Return Swaps	5,166	30	(154)	6,797	34	(175)
Total Non-Qualifying Hedges	$ 278,896	$ 11,570	$ (4,262)	$ 212,212	$ 10,469	$ (4,201)
Total Derivatives(1)	$ 289,334	$ 11,823	$ (5,145)	$ 222,820	$ 10,764	$ (5,111)

(1) Excludes embedded derivatives which contain multiple underlyings. The fair value of these embedded derivatives was a net liability of $3,742 million as of September 30, 2012 and a net liability of $3,131 million as of December 31, 2011, included in “Future policy benefits” and “Fixed maturities, available-for-sale.”

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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 September 30, 2012					
	Realized Investment Gains/ (Losses)	Net Investment Income	Other Income	Interest Expense	Interest Credited To Policyholders’ Account Balances	Accumulated Other Comprehensive Income(1)
	(in millions)					
Qualifying Hedges						
Fair value hedges						
Interest Rate	$ 6	$ (23)	$ 0	$ 1	$ 5	$ 0
Currency	0	(1)	0	0	0	0
Total fair value hedges	6	(24)	0	1	5	0
Cash flow hedges						
Interest Rate	0	0	0	(5)	0	2
Currency/Interest Rate	0	(1)	(3)	0	0	(119)
Total cash flow hedges	0	(1)	(3)	(5)	0	(117)
Net investment hedges						
Currency(2)	0	0	0	0	0	(6)
Currency/Interest Rate	0	0	0	0	0	(10)
Total net investment hedges	0	0	0	0	0	(16)
Non-qualifying hedges						
Interest Rate	86	0	0	0	0	0
Currency	(119)	0	0	0	0	0
Currency/Interest Rate	(19)	0	0	0	0	0
Credit	(8)	0	0	0	0	0

Equity	(983)	0	0	0	0	0
Embedded Derivatives	(418)	0	0	0	0	0
Total non-qualifying hedges	(1,461)	0	0	0	0	0
Total	$ (1,455)	(25)	$ (3)	$ (4)	$ 5	$ (133)

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Nine Months Ended September 30, 2012					
	Realized Investment Gains/ (Losses)	Net Investment Income	Other Income	Interest Expense	Interest Credited To Policyholders’ Account Balances	Accumulated Other Comprehensive Income(1)
	(in millions)					
Qualifying Hedges						
Fair value hedges						
Interest Rate	$ (6)	$ (71)	$ 0	$ 4	$ 26	$ 0
Currency	2	(3)	0	0	0	0
Total fair value hedges	(4)	(74)	0	4	26	0
Cash flow hedges						
Interest Rate	0	0	0	(14)	0	8
Currency/Interest Rate	0	(4)	(5)	0	0	(47)
Total cash flow hedges	0	(4)	(5)	(14)	0	(39)
Net investment hedges						
Currency(2)	0	0	0	0	0	(8)
Currency/Interest Rate	0	0	0	0	0	78
Total net investment hedges	0	0	0	0	0	70
Non-qualifying hedges						
Interest Rate	1,303	0	0	0	0	0
Currency	(46)	0	0	0	0	0
Currency/Interest Rate	97	0	1	0	0	0
Credit	(36)	0	0	0	0	0
Equity	(1,983)	0	0	0	0	0
Embedded Derivatives	(241)	0	0	0	0	0
Total non-qualifying hedges	(906)	0	1	0	0	0
Total	$ (910)	$ (78)	$ (4)	$ (10)	$ 26	$ 31

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Three Months Ended September 30, 2011					
	Realized Investment Gains/ (Losses)	Net Investment Income	Other Income	Interest Expense	Interest Credited To Policyholders’ Account Balances	Accumulated Other Comprehensive Income(1)
	(in millions)					
Qualifying Hedges						
Fair value hedges						
Interest Rate	$ (115)	$ (28)	$ 0	$ 3	$ 14	$ 0
Currency	47	(1)	0	0	0	0
Total fair value hedges	(68)	(29)	0	3	14	0
Cash flow hedges						
Interest Rate	0	0	0	(5)	0	(15)
Currency/Interest Rate	0	(4)	22	0	0	272
Total cash flow hedges	0	(4)	22	(5)	0	257
Net investment hedges						
Currency(2)	0	0	0	0	0	3
Currency/Interest Rate	0	0	0	0	0	(30)
Total net investment hedges	0	0	0	0	0	(27)
Non-qualifying hedges						
Interest Rate	4,213	0	0	0	0	0
Currency	292	0	0	0	0	0
Currency/Interest Rate	73	0	0	0	0	0
Credit	9	0	0	0	0	0
Equity	1,329	0	0	0	0	0
Embedded Derivatives	(3,360)	0	0	0	0	0
Total non-qualifying hedges	2,556	0	0	0	0	0
Total	$ 2,488	$ (33)	$ 22	$ (2)	$ 14	$ 230

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

	Nine Months Ended September 30, 2011					
	Realized Investment Gains/ (Losses)	Net Investment Income	Other Income	Interest Expense	Interest Credited To Policyholders’ Account Balances	Accumulated Other Comprehensive Income(1)
	(in millions)					
Qualifying Hedges						
Fair value hedges						
Interest Rate	$ (119)	$ (87)	$ 0	$ 7	$ 44	$ 0
Currency	15	(4)	0	0	0	0
Total fair value hedges	(104)	(91)	0	7	44	0
Cash flow hedges						
Interest Rate	0	0	0	(15)	(1)	(9)
Currency/Interest Rate	0	(10)	23	0	0	168
Total cash flow hedges	0	(10)	23	(15)	(1)	159
Net investment hedges						
Currency(2)	(9)	0	0	0	0	(4)
Currency/Interest Rate	0	0	0	0	0	(4)
Total net investment hedges	(9)	0	0	0	0	(8)
Non-qualifying hedges						
Interest Rate	4,615	0	0	0	0	0
Currency	128	0	0	0	0	0
Currency/Interest Rate	24	0	0	0	0	0
Credit	(29)	0	0	0	0	0
Equity	848	0	0	0	0	0
Embedded Derivatives	(2,865)	0	0	0	0	0
Total non-qualifying hedges	2,721	0	0	0	0	0
Total	$ 2,608	$ (101)	$ 23	$ (8)	$ 43	$ 151

(1) Amounts deferred in “Accumulated other comprehensive income (loss).”
(2) Relates to the sale of equity method investments.

For the three and nine months ended September 30, 2012, the ineffective portion of derivatives accounted for using hedge accounting was not material to the Company’s results of operations and there were no material amounts reclassified into earnings relating to instances in which the Company discontinued cash flow hedge accounting because the forecasted transaction did not occur by the anticipated date or within the additional time period permitted by the authoritative guidance for the accounting for derivatives and hedging. In addition, there were no instances in which the Company discontinued fair value hedge accounting due to a hedged firm commitment no longer qualifying as a fair value hedge.

Presented below is a roll forward of current period cash flow hedges in “Accumulated other comprehensive income (loss)” before taxes:

		(in millions)
Balance, December 31, 2011	$	(86)
Net deferred gains/(losses) on cash flow hedges from January 1 to September 30, 2012		(62)
Amount reclassified into current period earnings		23
Balance, September 30, 2012	$	(125)

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Using September 30, 2012 values, it is anticipated that a pre-tax loss of approximately $22 million will be reclassified from “Accumulated other comprehensive income (loss)” to earnings during the subsequent twelve months ending September 30, 2013, offset by amounts pertaining to the hedged items. As of September 30, 2012, the Company does not have any qualifying cash flow hedges of forecasted transactions other than those related to the variability of the payment or receipt of interest or foreign currency amounts on existing financial instruments. The maximum length of time for which these variable cash flows are hedged is 19 years. Income amounts deferred in “Accumulated other comprehensive income (loss)” as a result of cash flow hedges are included in “Net unrealized investment gains (losses)” in the Consolidated Statements of Equity.

For effective net investment hedges, the amounts, before applicable taxes, recorded in the cumulative translation adjustment account within “Accumulated other comprehensive income (loss)” was $(31) million and $(102) million as of September 30, 2012 and December 31, 2011.

Credit Derivatives Written

The following table sets forth the Company’s exposure from credit derivatives where the Company has written credit protection, by NAIC rating of the underlying credits as of September 30, 2012 and December 31, 2011. The Company’s maximum amount at risk under these credit derivatives listed below assumes the value of the underlying referenced securities become worthless. These credit derivatives generally have maturities of less than 5 years. The table excludes a credit derivative related to surplus notes issued by a subsidiary of Prudential Insurance and embedded derivatives contained in externally-managed investments in the European market.

		September 30, 2012 Single Name		December 31, 2011 Single Name	
NAIC Designation		**Notional**	**Fair Value**	**Notional**	**Fair Value**
		(in millions)			
	1	$ 295	$ 1	$ 795	$ 3
	2	25	0	25	0
Subtotal		320	1	820	3
	3	0	0	0	0
	4	0	0	0	0
	5	0	0	0	0
	6	0	0	0	0
Subtotal		0	0	0	0
Total		$ 320	$ 1	$ 820	$ 3

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The following table sets forth the composition of the Company’s credit derivatives where the Company has written credit protection by industry category as of the dates indicated.

Industry	September 30, 2012 Notional	September 30, 2012 Fair Value	December 31, 2011 Notional	December 31, 2011 Fair Value
	(in millions)			
Corporate Securities:				
Consumer Non-cyclical	$ 120	$ 1	$ 120	$ 1
Capital Goods	90	0	90	1
Basic Industry	40	0	40	0
Transportation	25	0	25	0
Consumer Cyclical	20	0	20	0
Energy	20	0	20	0
Communication	5	0	5	0
Finance	0	0	500	1
Total Credit Derivatives	$ 320	$ 1	$ 820	$ 3

In addition to the above, the Company entered into a credit derivative that will require the Company to make certain payments in the event of deterioration in the value of the surplus notes issued by a subsidiary of Prudential Insurance. The notional of this credit derivative is $500 million and the fair value as of September 30, 2012 and December 31, 2011 was a liability of $46 million and $77 million, respectively. No collateral was pledged in either period.

The Company holds certain externally-managed investments in the European market which contain embedded derivatives whose fair values are primarily driven by changes in credit spreads. These investments are medium-term notes that are collateralized by investment portfolios primarily consisting of investment grade European fixed income securities, including corporate bonds and asset-backed securities, and derivatives, as well as varying degrees of leverage. The notes have a stated coupon and provide a return based on the performance of the underlying portfolios and the level of leverage. The Company invests in these notes to earn a coupon through maturity, consistent with its investment purpose for other debt securities. The notes are accounted for under U.S. GAAP as available-for-sale fixed maturity securities with bifurcated embedded derivatives (total return swaps). Changes in the value of the fixed maturity securities are reported in Equity under the heading “Accumulated Other Comprehensive Income (Loss)” and changes in the market value of the embedded total return swaps are included in current period earnings in “Realized investment gains (losses), net.” The Company’s maximum exposure to loss from these investments was $312 million and $664 million at September 30, 2012 and December 31, 2011, respectively.

In addition to writing credit protection, the Company has purchased credit protection using credit derivatives in order to hedge specific credit exposures in the Company’s investment portfolio. As of September 30, 2012 and December 31, 2011, the Company had $1.729 billion and $1.978 billion of outstanding notional amounts, respectively, reported at fair value as a liability of $32 million and an asset of $2 million, respectively.

Types of Derivative Instruments and Derivative Strategies used in a dealer or broker capacity

Futures, forwards and options contracts, and swap agreements, were also used in a derivative dealer or broker capacity in the Company’s commodities operations, prior to the sale of this business to Jefferies on July 1, 2011, to facilitate transactions of clients, hedge proprietary trading activities and as a means of risk management.

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These derivatives allowed the Company to structure transactions to manage its exposure to commodities and securities prices, foreign exchange rates and interest rates. Risk exposures were managed through diversification, by controlling position sizes and by entering into offsetting positions.

The fair value of the Company’s derivative contracts used in a derivative dealer or broker capacity were reported on a net-by-counterparty basis in the Company’s Consolidated Statements of Financial Position when management believes a legal right of setoff exists under an enforceable netting agreement.

Realized and unrealized gains and losses from marking-to-market the derivatives used in proprietary positions were recognized on a trade date basis and reported in “Income from discontinued operations, net of taxes.” The pre-tax amounts reported in “Income (loss) from discontinued operations, net of taxes” for these derivatives were gains of $0 million and $63 million for the three and nine months ended September 30, 2011.

Counterparty Credit Risk

The Company is exposed to credit-related losses in the event of non-performance by counterparties to financial derivative transactions. The Company manages credit risk by entering into derivative transactions with highly rated major international financial institutions and other creditworthy counterparties, and by obtaining collateral where appropriate. Additionally, limits are set on single party credit exposures which are subject to periodic management review.

The credit exposure of the Company’s over-the-counter (“OTC”) derivative transactions is represented by the contracts with a positive fair value (market value) at the reporting date. To reduce credit exposures, the Company seeks to (i) enter into OTC derivative transactions pursuant to master agreements that provide for a netting of payments and receipts with a single counterparty (ii) enter into agreements that allow the use of credit support annexes (“CSAs”), which are bilateral rating-sensitive agreements that require collateral postings at established threshold levels. Likewise, the Company effects exchange-traded futures and options transactions through regulated exchanges and these transactions are settled on a daily basis, thereby reducing credit risk exposure in the event of non-performance by counterparties to such financial instruments.

Under fair value measurements, the Company incorporates the market’s perception of its own and the counterparty’s non-performance risk in determining the fair value of the portion of its OTC derivative assets and liabilities that are uncollateralized. Credit spreads are applied to the derivative fair values on a net basis by counterparty. To reflect the Company’s own credit spread a proxy based on relevant debt spreads is applied to OTC derivative net liability positions. Similarly, the Company’s counterparty’s credit spread is applied to OTC derivative net asset positions.

Certain of the Company’s derivative agreements with some of its counterparties contain credit-rating related triggers. If the Company’s credit rating were to fall below a certain level, the counterparties to the derivative instruments could request termination at the then fair value of the derivative or demand immediate full collateralization on derivative instruments in net liability positions. If a downgrade occurred and the derivative positions were terminated, the Company anticipates it would be able to replace the derivative positions with other counterparties in the normal course of business. The aggregate fair value of all derivative instruments with credit-risk-related contingent features that are in a net liability position were $133 million as of September 30, 2012. In the normal course of business the Company has posted collateral related to these instruments of $123 million as of September 30, 2012. If the credit-risk-related contingent features underlying these agreements had been triggered on September 30, 2012, the Company estimates that it would be required to post a maximum of $10 million of additional collateral to its counterparties.

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

15. COMMITMENTS AND GUARANTEES, CONTINGENT LIABILITIES AND LITIGATION AND REGULATORY MATTERS

Commitments and Guarantees

Commercial Mortgage Loan Commitments

	As of September 30, 2012 (in millions)
Total outstanding mortgage loan commitments	$ 2,123
Portion of commitment where prearrangement to sell to investor exists	$ 1,199

In connection with the Company’s commercial mortgage operations, it originates commercial mortgage loans. Commitments for loans that will be held for sale are recognized as derivatives and recorded at fair value. In certain of these transactions, the Company pre-arranges that it will sell the loan to an investor, including to governmental sponsored entities as discussed below, after the Company funds the loan.

Commitments to Purchase Investments (excluding Commercial Mortgage Loans)

	As of September 30, 2012 (in millions)
Expected to be funded from the general account and other operations outside the separate accounts(1)	$ 3,731
Expected to be funded from separate accounts	$ 976
Portion of separate account commitments with recourse to Prudential Insurance	$ 125

(1) Includes a remaining commitment of $212 million related to the Company’s agreement to co-invest with the Fosun Group (Fosun) in a private equity fund, managed by Fosun, for the Chinese marketplace.

The Company has other commitments to purchase or fund investments, some of which are contingent upon events or circumstances not under the Company’s control, including those at the discretion of the Company’s counterparties. The Company anticipates a portion of these commitments will ultimately be funded from its separate accounts. Some of the separate account commitments have recourse to Prudential Insurance if the separate accounts are unable to fund the amounts when due.

Transitional Financing Facilities Issued in Connection with Sale of PRERS

	As of September 30, 2012 (in millions)
Total remaining available credit lines	$ 92

In connection with the sale of the real estate brokerage franchise and relocation business, the Company agreed to provide the buyer with transitional financing for the transferred relocation services business. The Company originally provided three credit facilities: two six month facilities that were repaid and expired on June 6, 2012 and a three year facility that was repaid and terminated on October 26, 2012.

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Guarantees of Investee Debt

		As of September 30, 2012 (in millions)
Total guarantees of debt issued by entities in which the separate accounts have invested	$	2,439
Amount of above guarantee that is limited to separate account assets	$	2,372
Accrued liability associated with guarantee	$	0

A number of guarantees provided by the Company relate to real estate investments held in its separate accounts, in which entities that the separate account has invested in have borrowed funds, and the Company has guaranteed their obligations. The Company provides these guarantees to assist these entities in obtaining financing. The Company’s maximum potential exposure under these guarantees is mostly limited to the assets of the separate account. The exposure that is not limited to the separate account assets relates mostly to guarantees limited to fraud, criminal activity or other bad acts. These guarantees generally expire at various times over the next thirteen years. At September 30, 2012, the Company’s assessment is that it is unlikely payments will be required. Any payments that may become required under these guarantees would either first be reduced by proceeds received by the creditor on a sale of the underlying collateral, or would provide rights to obtain the underlying collateral.

Indemnification of Securities Lending Transactions

		As of September 30, 2012 (in millions)
Indemnification provided to mutual fund and separate account clients for securities lending	$	15,850
Fair value of related collateral associated with above indemnifications	$	16,303
Accrued liability associated with guarantee	$	0

In the normal course of business, the Company may facilitate securities lending transactions on behalf of mutual funds and separate accounts for which the Company is the investment advisor and/or the asset manager. In certain of these arrangements, the Company has provided an indemnification to the mutual funds or separate accounts to hold them harmless against losses caused by counterparty (i.e., borrower) defaults associated with the securities lending activity facilitated by the Company. Collateral is provided by the counterparty to the mutual fund or separate account at the inception of the loan equal to or greater than 102% of the fair value of the loaned securities and the collateral is maintained daily at 102% or greater of the fair value of the loaned securities. The Company is only at risk if the counterparty to the securities lending transaction defaults and the value of the collateral held is less than the value of the securities loaned to such counterparty. The Company believes the possibility of any payments under these indemnities is remote.

Credit Derivatives Written

As discussed further in Note 14, the Company writes credit derivatives under which the Company is obligated to pay the counterparty the referenced amount of the contract and receive in return the defaulted security or similar security.

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Guarantees of Global Commodities Business

	As of September 30, 2012 (in millions)
Exposure under the guarantees	$ 4
Accrued liability associated with guarantees	$ 0

In conjunction with the sale of the Global Commodities Business, the Company entered into a guarantees transition and collateral agreement with Jefferies, pursuant to which the Company agreed to keep these guarantees outstanding until January 2013, including with respect to business conducted by the transferred entities with beneficiaries of these guarantees subsequent to the closing date. Jefferies has agreed to indemnify the Company for any amounts payable under the guarantees and, under certain conditions, provide collateral for such obligation. As of September 30, 2012, no collateral has been provided by Jefferies.

Guarantees of Asset Values

	As of September 30, 2012 (in millions)
Guaranteed value of third parties assets	$ 60,738
Fair value of collateral supporting these assets	$ 63,981
Asset associated with guarantee, carried at fair value	$ 9

Certain contracts underwritten by the Retirement segment include guarantees related to financial assets owned by the guaranteed party. These contracts are accounted for as derivatives and carried at fair value. The collateral supporting these guarantees is not reflected on the Company’s balance sheet.

Guarantees of Credit Enhancements

	As of September 30, 2012 (in millions)
Guarantees of credit enhancements of debt instruments associated with commercial real estate assets	$ 148
Fair value of properties and associated tax credits that secure the guarantee	$ 172
Accrued liability associated with guarantee	$ 0

The Company arranges for credit enhancements of certain debt instruments that provide financing primarily for affordable multi-family real estate assets, including certain tax-exempt bond financings. The credit enhancements provide assurances to the debt holders as to the timely payment of amounts due under the debt instruments. The remaining contractual maturities for these guarantees are up to fifteen years. The Company’s obligations to reimburse required credit enhancement payments are secured by mortgages on the related real estate. The Company receives certain ongoing fees for providing these enhancement arrangements and anticipates the extinguishment of its obligation under these enhancements prior to maturity through the aggregation and transfer of its positions to a substitute enhancement provider.

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Indemnification of Serviced Mortgage Loans

		As of September 30, 2012 (in millions)
Maximum exposure under indemnification agreements for mortgage loans serviced by the Company	$	1,086
First-loss exposure portion of above	$	350
Accrued liability associated with guarantees	$	19

As part of the commercial mortgage activities of the Company’s Asset Management segment, the Company provides commercial mortgage origination, underwriting and servicing for certain government sponsored entities, such as Fannie Mae and Freddie Mac. The Company has agreed to indemnify the government sponsored entities for a portion of the credit risk associated with certain of the mortgages it services through a delegated authority arrangement. Under these arrangements, the Company originates multi-family mortgages for sale to the government sponsored entities based on underwriting standards they specify, and makes payments to them for a specified percentage share of losses they incur on certain loans serviced by the Company. The Company’s percentage share of losses incurred generally varies from 2% to 20% of the loan balance, and is typically based on a first-loss exposure for a stated percentage of the loan balance, plus a shared exposure with the government sponsored entity for any losses in excess of the stated first-loss percentage, subject to a contractually specified maximum percentage. The Company services $8,066 million of mortgages subject to these loss-sharing arrangements as of September 30, 2012, all of which are collateralized by first priority liens on the underlying multi-family residential properties. As of September 30, 2012, these mortgages had an average debt service coverage ratio of 1.75 times and an average loan-to-value ratio of 63%. The Company’s total share of losses related to indemnifications that were settled was $2 million and $1 million, for the nine months ended September 30, 2012 and 2011, respectively.

Contingent Consideration

		As of September 30, 2012 (in millions)
Maximum potential contingent consideration associated with acquisitions	$	52

In connection with the Company’s initial investment in an operating joint venture, the Company has agreed to pay additional consideration in future periods, contingent upon the attainment of defined operating objectives. The arrangement will be resolved over the following nine months. Any payment would result in an increase to the Company’s investment in the operating joint venture. The Company considers the likelihood that the defined operating objectives will be met to be remote.

Other Guarantees

		As of September 30, 2012 (in millions)
Other guarantees where amount can be determined	$	438
Accrued liability for other guarantees and indemnifications	$	9

The Company is also subject to other financial guarantees and indemnity arrangements. The Company has provided indemnities and guarantees related to acquisitions, dispositions, investments and other transactions that are triggered by, among other things, breaches of representations, warranties or covenants provided by the

PRUDENTIAL FINANCIAL, INC.

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Company. These obligations are typically subject to various time limitations, defined by the contract or by operation of law, such as statutes of limitation. In some cases, the maximum potential obligation is subject to contractual limitations, while in other cases such limitations are not specified or applicable. Included above are $299 million of yield maintenance guarantees related to certain investments the Company sold. The Company does not expect to make any payments on these guarantees and is not carrying any liabilities associated with these guarantees.

Since certain of these obligations are not subject to limitations, it is not possible to determine the maximum potential amount due under these guarantees. The accrued liabilities identified above do not include retained liabilities associated with sold businesses.

Contingent Liabilities

On an ongoing basis, the Company’s internal supervisory and control functions review the quality of sales, marketing and other customer interface procedures and practices and may recommend modifications or enhancements. From time to time, this review process results in the discovery of product administration, servicing or other errors, including errors relating to the timing or amount of payments or contract values due to customers. In certain cases, if appropriate, the Company may offer customers remediation and may incur charges, including the cost of such remediation, administrative costs and regulatory fines.

The Company is subject to the laws and regulations of states and other jurisdictions concerning the identification, reporting and escheatment of unclaimed or abandoned funds, and is subject to audit and examination for compliance with these requirements. For additional discussion of these matters, see “Litigation and Regulatory Matters” below.

It is possible that the results of operations or the cash flow of the Company in a particular quarterly or annual period could be materially affected as a result of payments in connection with the matters discussed above or other matters depending, in part, upon the results of operations or cash flow for such period. Management believes, however, that ultimate payments in connection with these matters, after consideration of applicable reserves and rights to indemnification, should not have a material adverse effect on the Company’s financial position.

Litigation and Regulatory Matters

The Company is subject to legal and regulatory actions in the ordinary course of its businesses. Pending legal and regulatory actions include proceedings relating to aspects of the Company’s businesses and operations that are specific to it and proceedings that are typical of the businesses in which it operates, including in both cases businesses that have been either divested or placed in wind-down status. Some of these proceedings have been brought on behalf of various alleged classes of complainants. In certain of these matters, the plaintiffs are seeking large and/or indeterminate amounts, including punitive or exemplary damages. The outcome of litigation or a regulatory matter, and the amount or range of potential loss at any particular time, is often inherently uncertain.

The Company establishes accruals for litigation and regulatory matters when it is probable that a loss has been incurred and the amount of that loss can be reasonably estimated. For litigation and regulatory matters where a loss may be reasonably possible, but not probable, or is probable but not reasonably estimable, no accrual is established but the matter, if material, is disclosed, including matters discussed below. The Company estimates that as of September 30, 2012, the aggregate range of reasonably possible losses in excess of accruals established for those litigation and regulatory matters for which such an estimate currently can be made is $0 to

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approximately $250 million. This estimate is not an indication of expected loss, if any, or the Company’s maximum possible loss exposure on such matters. The Company reviews relevant information with respect to its litigation and regulatory matters on a quarterly and annual basis and updates its accruals, disclosures and estimates of reasonably possible loss based on such reviews.

Individual Life and Group Insurance

In September 2012, the State of West Virginia, through its State Treasurer, filed a lawsuit, *State of West Virginia ex. Rel. John D. Perdue v. Prudential Insurance Company of America*, in the Circuit Court of Putnam County, West Virginia. The complaint alleges violations of the West Virginia Uniform Unclaimed Property Fund Act by failing to properly identify and report all unclaimed insurance policy proceeds which should either be paid to beneficiaries or escheated to West Virginia. The complaint seeks to examine the records of Prudential Insurance to determine compliance with the West Virginia Uniform Unclaimed Property Fund Act, and to assess penalties and costs in an undetermined amount.

In January 2012, a *qui tam* action on behalf of the State of Illinois, *Total Asset Recovery Services v. Met Life Inc, et al., Prudential Financial, Inc., The Prudential Insurance Company of America, and Prudential Holdings, LLC*, filed in the Circuit Court of Cook County, Illinois, was served on the Company. The complaint alleges that the Company failed to escheat life insurance proceeds to the State of Illinois in violation of the Illinois False Claims Whistleblower Reward and Protection Act and seeks injunctive relief, compensatory damages, civil penalties, treble damages, prejudgment interest, attorneys’ fees and costs. In April 2012, the Company filed a motion to dismiss the complaint. In September 2012, the complaint was withdrawn without prejudice. In March 2012, a *qui tam* action on behalf of the State of Minnesota, *Total Asset Recovery v. MetLife Inc., et al., Prudential Financial Inc., The Prudential Insurance Company of America and Prudential Holdings, Inc.*, filed in the Fourth Judicial District, Hennepin County, in the State of Minnesota was served on the Company. The complaint alleges that the Company failed to escheat life insurance proceeds to the State of Minnesota in violation of the Minnesota False Claims Act and seeks injunctive relief, compensatory damages, civil penalties, treble damages, prejudgment interest, attorneys’ fees and costs. In June 2012, the Company filed a motion to dismiss the complaint.

In January 2012, a Global Resolution Agreement entered into by the Company and a third party auditor became effective upon its acceptance by the unclaimed property departments of 20 states and jurisdictions. Under the terms of the Global Resolution Agreement, the third party auditor acting on behalf of the signatory states will compare expanded matching criteria to the Social Security Master Death File (“SSMDF”) to identify deceased insureds and contract holders where a valid claim has not been made. In February 2012, a Regulatory Settlement Agreement entered into by the Company to resolve a multi-state market conduct examination regarding its adherence to state claim settlement practices became effective upon its acceptance by the insurance departments of 20 states and jurisdictions. The Regulatory Settlement Agreement applies prospectively and requires the Company to adopt and implement additional procedures comparing its records to the SSMDF to identify unclaimed death benefits and proscribes procedures for identifying and locating beneficiaries once deaths are identified. Other jurisdictions that are not signatories to the Regulatory Settlement Agreement are considering proposals that would apply prospectively and require life insurance companies to take additional steps to identify unreported deceased policy and contract holders. These prospective changes and any escheatable property identified as a result of the audits and inquiries could result in: (1) additional payments of previously unclaimed death benefits; (2) the payment of abandoned funds to U.S. jurisdictions; and (3) changes in the Company’s practices and procedures for the identification of escheatable funds and beneficiaries, which would impact claim payments and reserves, among other consequences.

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Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

The Company is one of several companies subpoenaed by the New York Attorney General regarding its unclaimed property procedures. Additionally, the New York State Department of Financial Services (“NYDFS”) has requested that 172 life insurers (including the Company) provide data to the NYDFS regarding use of the SSMDF. The New York Office of Unclaimed Funds recently notified the Company that it intends to conduct an audit of the Company’s compliance with New York’s unclaimed property laws. The Minnesota Attorney General has also requested information regarding the Company’s use of the SSMDF and its claim handling procedures and the Company is one of several companies subpoenaed by the Minnesota Department of Commerce, Insurance Division. In February 2012, the Massachusetts Office of the Attorney General requested information regarding the Company’s unclaimed property procedures.

From July 2010 to December 2010, four purported nationwide class actions were filed challenging the use of retained asset accounts to settle death benefit claims of beneficiaries of a group life insurance contract owned by the United States Department of Veterans Affairs that covers the lives of members and veterans of the U.S. armed forces. In 2011, the cases were consolidated in the United States District Court for the District of Massachusetts by the Judicial Panel for Multi-District Litigation as *In re Prudential Insurance Company of America SGLI/VGLI Contract Litigation.* The consolidated complaint alleges that the use of the retained assets accounts that earn interest and are available to be withdrawn by the beneficiary, in whole or in part, at any time, to settle death benefit claims is in violation of federal law, and asserts claims of breach of contract, breaches of fiduciary duty and the duty of good faith and fair dealing, fraud and unjust enrichment and seeks compensatory and punitive damages, disgorgement of profits, equitable relief and pre and post-judgment interest. In March 2011, the motion to dismiss was denied. In January 2012, plaintiffs filed a motion to certify the class. In August 2012, the court denied plaintffs’ class certification motion without prejudice pending the filing of summary judgment motions on the issue of whether plaintiffs sustained an actual injury. In October 2012, the parties filed their summary judgment motions.

In September 2010, *Huffman v. The Prudential Insurance Company*, a purported nationwide class action brought on behalf of beneficiaries of group life insurance contracts owned by ERISA-governed employee welfare benefit plans was filed in the United States District Court for the Eastern District of Pennsylvania, challenging the use of retained asset accounts in employee welfare benefit plans to settle death benefit claims as a violation of ERISA and seeking injunctive relief and disgorgement of profits. In July 2011, the Company’s motion for judgment on the pleadings was denied. In February 2012, plaintiffs filed a motion to certify the class. In April 2012, the Court stayed the case pending the outcome of a case involving another insurer that is on appeal to the Third Circuit Court of Appeals.

In January 2011, a purported state-wide class action, *Garcia v. The Prudential Insurance Company of America* was dismissed by the Second Judicial District Court, Washoe County, Nevada. The complaint was brought on behalf of Nevada beneficiaries of individual life insurance policies for which, unless the beneficiaries elected another settlement method, death benefits were placed in retained asset accounts. The complaint alleges that by failing to disclose material information about the accounts, the Company wrongfully delayed payment and improperly retained undisclosed profits, and seeks damages, injunctive relief, attorneys’ fees and pre and post-judgment interest. In February 2011, plaintiff appealed the dismissal to the Nevada Supreme Court. As previously reported, in December 2009, an earlier purported nationwide class action raising substantially similar allegations brought by the same plaintiff in the United States District Court for the District of New Jersey, *Garcia v. Prudential Insurance Company of America*, was dismissed. In December 2010, a purported state-wide class action complaint, *Phillips v. Prudential Financial, Inc.*, was filed in state court and removed to the United States District Court for the Southern District of Illinois. The complaint makes allegations under Illinois law, substantially similar to the *Garcia* cases, on behalf of a class of Illinois residents whose death benefit claims were settled by retained assets accounts. In March 2011, the complaint was amended to drop the Company as a defendant and add Pruco Life Insurance Company as a defendant and is now captioned *Phillips v. Prudential Insurance and Pruco Life Insurance Company*. In November 2011, the complaint was dismissed. In December 2011, plaintiffs appealed the dismissal.

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In July 2010, the Company, along with other life insurance industry participants, received a formal request for information from the State of New York Attorney General’s Office in connection with its investigation into industry practices relating to the use of retained asset accounts. In August 2010, the Company received a similar request for information from the State of Connecticut Attorney General’s Office. The Company is cooperating with these investigations. The Company has also been contacted by state insurance regulators and other governmental entities, including the U.S. Department of Veterans Affairs and Congressional committees regarding retained asset accounts. These matters may result in additional investigations, information requests, claims, hearings, litigation, adverse publicity and potential changes to business practices.

In February 2011, a fifth amended complaint was filed in the United States District Court for the District of New Jersey in *Clark v. Prudential Insurance Company*. The complaint brought on behalf of a purported class of California, Indiana, Ohio and Texas residents who purchased individual health insurance policies alleges that Prudential Insurance failed to disclose that it had ceased selling this type of policy in 1981 and that, as a result, premiums would increase significantly. The complaint alleges claims of fraudulent misrepresentation and omission, breach of the duty of good faith and fair dealing, and California’s Unfair Competition Law and seeks compensatory and punitive damages. The matter was originally filed in 2008 and certain of the claims in the first four complaints were dismissed. In February 2012, plaintiffs filed a motion for class certification. That motion is pending decision by the court. In July 2012, Prudential Insurance moved for summary judgment on certain of plaintiffs’ claims.

In April 2009, *Schultz v. The Prudential Insurance Company of America,* a purported nationwide class action on behalf of participants claiming disability benefits under certain employee benefit plans insured by Prudential, was filed in the United States District Court for the Northern District of Illinois. As amended, the complaint alleges that Prudential Insurance and the defendant plans violated ERISA by characterizing family Social Security benefits as “loss of time” benefits that were offset against Prudential contract benefits. The complaint seeks a declaratory judgment that the offsets were improper, damages and other relief. The Company has agreed to indemnify the named defendant plans. In April 2011, *Schultz* was dismissed with prejudice, and plaintiffs appealed to the Seventh Circuit Court of Appeals. In March 2012, the court affirmed the dismissal.

From November 2002 to March 2005, eleven separate complaints were filed against the Company and the law firm of Leeds Morelli & Brown in New Jersey state court and in the New Jersey Superior Court, Essex County as *Lederman v. Prudential Financial, Inc., et al.* The complaints allege that an alternative dispute resolution agreement entered into among Prudential Insurance, over 235 claimants who are current and former Prudential Insurance employees, and Leeds Morelli & Brown (the law firm representing the claimants) was illegal and that Prudential Insurance conspired with Leeds Morelli & Brown to commit fraud, malpractice, breach of contract, and violate racketeering laws by advancing legal fees to the law firm with the purpose of limiting Prudential’s liability to the claimants. In February 2010, the New Jersey Supreme Court assigned the cases for centralized case management to the Superior Court, Bergen County. The Company participated in a court-ordered mediation that resulted in a settlement involving 193 of the remaining 235 plaintiffs. The amounts paid to the 193 plaintiffs were within existing reserves for this matter. The remaining plaintiffs continue to pursue their individual lawsuits, and have filed offers of judgment totaling approximately $90 million. In June 2012, the court granted summary judgment against an additional plaintiff reducing to 39 the number of plaintiffs asserting claims against the Company.

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Retirement Solutions and Investment Management

In October 2007, Prudential Retirement Insurance and Annuity Co. (“PRIAC”) filed an action in the United States District Court for the Southern District of New York, *Prudential Retirement Insurance & Annuity Co. v. State Street Global Advisors,* in PRIAC’s fiduciary capacity and on behalf of certain defined benefit and defined contribution plan clients of PRIAC, against an unaffiliated asset manager, State Street Global Advisors (“SSgA”) and SSgA’s affiliate, State Street Bank and Trust Company (“State Street”). This action seeks, among other relief, restitution of certain losses attributable to certain investment funds sold by SSgA as to which PRIAC believes SSgA employed investment strategies and practices that were misrepresented by SSgA and failed to exercise the standard of care of a prudent investment manager. Given the unusual circumstances surrounding the management of these SSgA funds and in order to protect the interests of the affected plans and their participants while PRIAC pursues these remedies, PRIAC implemented a process under which affected plan clients that authorized PRIAC to proceed on their behalf have received payments from funds provided by PRIAC for the losses referred to above. The Company’s consolidated financial statements, and the results of the Retirement segment included in the Company’s U.S. Retirement Solutions and Investment Management Division, for the year ended December 31, 2007 include a pre-tax charge of $82 million, reflecting these payments to plan clients and certain related costs. In September 2008, the United States District Court for the Southern District of New York denied the State Street defendants’ motion to dismiss claims for damages and other relief under Section 502(a)(2) of ERISA, but dismissed the claims for equitable relief under Section 502(a)(3) of ERISA. In October 2008, defendants answered the complaint and asserted counterclaims for contribution and indemnification, defamation and violations of Massachusetts’ unfair and deceptive trade practices law. In February 2010, State Street reached a settlement with the SEC over charges that it misled investors about their exposure to sub-prime investments, resulting in significant investor losses in mid-2007. Under the settlement, State Street paid approximately $313 million in disgorgement, pre-judgment interest, penalty and compensation into a Fair Fund that was distributed to injured investors and consequently, State Street paid PRIAC, for deposit into its separate accounts, approximately $52.5 million. By the terms of the settlement, State Street’s payment to PRIAC does not resolve any claims PRIAC has against State Street or SSgA in connection with the losses in the investment funds SSgA managed, and the penalty component of State Street’s SEC settlement cannot be used to offset or reduce compensatory damages in the action against State Street and SSgA. In June 2010, PRIAC moved for partial summary judgment on State Street’s counterclaims. At the same time, State Street moved for summary judgment on PRIAC’s complaint. In March 2011, the district court denied State Street’s motion for summary judgment and denied in part and granted in part PRIAC’s motion for partial summary judgment on State Street’s counterclaims. In October 2011, the court held a bench trial to determine whether State Street had breached its fiduciary duty to PRIAC’s plan clients. In February 2012, the court issued a decision holding that State Street breached its fiduciary duty to the plans under ERISA to manage the investment funds prudently and to diversify them. The court held that PRIAC did not prove that State Street breached its duty of loyalty to the plans under ERISA. The court held that State Street’s breaches caused the plans’ losses in the amount of $76.7 million and, after crediting State Street for an earlier payment, awarded $28.1 million in damages in addition to the amount previously recovered as a result of the SEC settlement. The court has not yet ruled on State Street’s counterclaims and has reserved judgment on PRIAC’s requests for pre-judgment interest and attorney’s fees. In May 2012, the Company filed a motion seeking partial summary judgment to dismiss State Street’s counterclaims.

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

Other Matters

In October 2012, a shareholder derivative lawsuit, *Stephen Silverman, Derivatively on Behalf of Prudential Financial, Inc. v. John R. Strangfeld, et. al.*, was filed in the United States District Court for the District of New Jersey, alleging breaches of fiduciary duties, waste of corporate assets and unjust enrichment by certain senior officers and directors. The complaint names as defendants the Company’s Chief Executive Officer, the Chief Financial Officer, the Principal Accounting Officer, the Company’s Board of Directors and a former Director. The complaint alleges that the defendants made false and misleading statements regarding the Company’s current and future financial condition based on, among other things, the alleged failure to disclose: (i) potential liability for benefits that should either have been paid to policyholders or their beneficiaries, or escheated to applicable states; and (ii) the extent of the Company’s exposure for alleged state and federal law violations concerning the settlement of claims and the escheatment of unclaimed property. The complaint seeks an undetermined amount of damages, attorneys’ fees and costs, and equitable relief including a direction for the Company to reform and to improve its corporate governance and internal procedures to comply with applicable laws.

In October 2012, the Board of Directors received a shareholder demand letter (the “Demand”), containing allegations of wrongdoing similar to those alleged in the *Silverman* complaint. The Demand alleges that the Company’s Senior Management: (i) breached their fiduciary duties of loyalty and good faith in connection with the management, operation and oversight of the Company’s business; (ii) breached their fiduciary duty of good faith to establish and maintain adequate internal controls; and (iii) breached their fiduciary duties by disseminating false, misleading and/or incomplete information, all in connection with the Company’s alleged failure to use the SSDMF and to pay beneficiaries and escheat funds to states. The Demand requests that the Board of Directors: (a) undertake an independent internal investigation into Senior Management’s violations of New Jersey and/or federal law; and (b) commence a civil action against each member of Senior Management to recover for the benefit of the Company the amount of damages sustained by the Company as a result of the alleged breaches described above.

In August 2012, a purported class action lawsuit, *City of Sterling Heights General Employees’ Retirement System v. Prudential Financial, Inc., et al.*, was filed in the United States District Court for the District of New Jersey, alleging violations of federal securities law. The complaint names as defendants the Company’s Chief Executive Officer, the Chief Financial Officer, the Principal Accounting Officer and certain Company Board of Directors. The complaint alleges that knowingly false and misleading statements were made regarding the Company’s current and future financial condition based on, among other things, the alleged failure to disclose: (i) potential liability for benefits that should either have been paid to policyholders or their beneficiaries, or escheated to applicable states; and (ii) the extent of the Company’s exposure for alleged state and federal law violations concerning the settlement of claims and the escheatment of unclaimed property. The complaint seeks an undetermined amount of damages, interest, attorneys’ fees and costs.

In October 2006, a purported class action lawsuit, *Bouder v. Prudential Financial, Inc. and Prudential Insurance Company of America*, was filed in the United States District Court for the District of New Jersey, claiming that Prudential failed to pay overtime to insurance agents in violation of federal and Pennsylvania law, and that improper deductions were made from these agents’ wages in violation of state law. The complaint seeks back overtime pay and statutory damages, recovery of improper deductions, interest, and attorneys’ fees. In March 2008, the court conditionally certified a nationwide class on the federal overtime claim. Separately, in March 2008, a purported nationwide class action lawsuit was filed in the United States District Court for the Southern District of California, *Wang v. Prudential Financial, Inc. and Prudential Insurance,* claiming that the Company failed to pay its agents overtime and provide other benefits in violation of California and federal law and seeking compensatory and punitive damages in unspecified amounts. In September 2008, *Wang* was transferred to the United

States District Court for the District of New Jersey and consolidated with the *Bouder*

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements—(Continued)

matter. Subsequent amendments to the complaint have resulted in additional allegations involving purported violations of an additional nine states’ overtime and wage payment laws. In February 2010, Prudential moved to decertify the federal overtime class that had been conditionally certified in March 2008 and moved for summary judgment on the federal overtime claims of the named plaintiffs. In July 2010, plaintiffs filed a motion for class certification of the state law claims. In August 2010, the district court granted Prudential’s motion for summary judgment, dismissing the federal overtime claims. The motion for class certification of the state law claims is pending.

In April 2012, the Company filed two actions in New Jersey state court captioned *The Prudential Insurance Company of America, et al. v. JP Morgan Chase, et al.* and *The Prudential Insurance Company of America, et al. v. Morgan Stanley, et al.* Both matters seek to recover damages attributable to Company and affiliate entities’ and funds’ investments in residential mortgage-backed securities (“RMBS”). Among other allegations stemming from the defendants’ origination, underwriting and sales of RMBS, the complaints assert claims of common law fraud, negligent misrepresentation, breaches of the New Jersey Uniform Securities Act and breaches of the New Jersey Civil RICO statute. The complaints seek unspecified damages. In August 2012, the Company filed four additional actions in New Jersey state court captioned *The Prudential Insurance Company of America, et al.* v. *Nomura Securities International, Inc., et al.*, *The Prudential Insurance Company of America, et al.* v. *Barclays Bank PLC, et al,, The Prudential Insurance Company of America, et al.* v. *Goldman Sachs & Company, et al.* and *The Prudential Insurance Company of America, et al.* v. *RBS Financial Products, Inc., et al.* upon the same grounds and seeking the same damages, as articulated above.

Summary

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

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PRUDENTIAL FINANCIAL, INC.

Unaudited Interim Supplemental Combining Statements of Financial Position

September 30, 2012 and December 31, 2011 (in millions)

	September 30, 2012			December 31, 2011		
	Financial Services Businesses	Closed Block Business	Consolidated	Financial Services Businesses	Closed Block Business	Consolidated
ASSETS						
Fixed maturities, available-for-sale, at fair value	$ 226,015	$ 47,366	$ 273,381	$ 208,132	$ 46,516	$ 254,648
Fixed maturities, held-to-maturity, at amortized cost	4,720	0	4,720	5,107	0	5,107
Trading account assets supporting insurance liabilities, at fair value	20,132	0	20,132	19,481	0	19,481
Other trading account assets, at fair value	5,610	264	5,874	5,228	317	5,545
Equity securities, available-for-sale, at fair value	4,821	3,171	7,992	4,413	3,122	7,535
Commercial mortgage and other loans	27,057	9,765	36,822	26,391	9,040	35,431
Policy loans	6,551	5,150	11,701	6,263	5,296	11,559
Other long-term investments	6,133	2,022	8,155	5,830	1,990	7,820
Short-term investments	7,825	1,470	9,295	8,593	528	9,121
Total investments	308,864	69,208	378,072	289,438	66,809	356,247
Cash and cash equivalents	13,102	804	13,906	13,201	1,050	14,251
Accrued investment income	2,230	640	2,870	2,177	616	2,793
Deferred policy acquisition costs	13,250	416	13,666	12,056	461	12,517
Other assets	15,353	321	15,674	15,748	308	16,056
Separate account assets	247,510	0	247,510	218,380	0	218,380
TOTAL ASSETS	$ 600,309	$ 71,389	$ 671,698	$ 551,000	$ 69,244	$ 620,244
LIABILITIES AND EQUITY						
LIABILITIES						
Future policy benefits	$ 132,209	$ 50,953	$ 183,162	$ 119,248	$ 51,423	$ 170,671
Policyholders’ account balances	130,227	5,442	135,669	129,074	5,484	134,558
Policyholders’ dividends	252	7,310	7,562	286	5,511	5,797
Securities sold under agreements to repurchase	4,662	3,371	8,033	3,118	3,100	6,218
Cash collateral for loaned securities	2,442	934	3,376	2,254	719	2,973
Income taxes	9,318	(422)	8,896	6,993	(435)	6,558
Short-term debt	3,013	0	3,013	2,336	0	2,336
Long-term debt	22,095	1,750	23,845	22,872	1,750	24,622
Other liabilities	10,759	507	11,266	13,034	256	13,290
Separate account liabilities	247,510	0	247,510	218,380	0	218,380
Total liabilities	562,487	69,845	632,332	517,595	67,808	585,403
COMMITMENTS AND CONTINGENT LIABILITIES						
EQUITY						
Accumulated other comprehensive income	9,416	234	9,650	5,250	168	5,418
Other attributed equity	27,715	1,310	29,025	27,567	1,268	28,835
Total attributed equity	37,131	1,544	38,675	32,817	1,436	34,253

Noncontrolling interests	691	0	691	588	0	588
Total equity	37,822	1,544	39,366	33,405	1,436	34,841
TOTAL LIABILITIES AND EQUITY	$ 600,309	$ 71,389	$ 671,698	$ 551,000	$ 69,244	$ 620,244

See Notes to Unaudited Interim Supplemental Combining Financial Information

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PRUDENTIAL FINANCIAL, INC.

Unaudited Interim Supplemental Combining Statements of Operations

Three Months Ended September 30, 2012 and 2011 (in millions)

	Three Months Ended September 30,					
	2012			2011		
	Financial Services Businesses	Closed Block Business	Consolidated	Financial Services Businesses	Closed Block Business	Consolidated
REVENUES						
Premiums	$ 8,382	$ 645	$ 9,027	$ 5,417	$ 667	$ 6,084
Policy charges and fee income	1,224	0	1,224	958	0	958
Net investment income	2,665	768	3,433	2,543	790	3,333
Asset management fees and other income	888	17	905	2,030	(2)	2,028
Realized investment gains (losses), net:						
Other-than-temporary impairments on fixed maturity securities	(267)	(159)	(426)	(275)	(127)	(402)
Other-than-temporary impairments on fixed maturity securities transferred to Other Comprehensive Income	185	146	331	174	112	286
Other realized investment gains (losses), net	(1,437)	87	(1,350)	2,389	255	2,644
Total realized investment gains (losses), net	(1,519)	74	(1,445)	2,288	240	2,528
Total revenues	11,640	1,504	13,144	13,236	1,695	14,931
BENEFITS AND EXPENSES						
Policyholders’ benefits	8,800	776	9,576	5,380	828	6,208
Interest credited to policyholders’ account balances	1,023	34	1,057	1,428	35	1,463
Dividends to policyholders	39	478	517	40	639	679
Amortization of deferred policy acquisition costs	173	9	182	1,501	9	1,510
General and administrative expenses	2,641	138	2,779	2,527	138	2,665
Total benefits and expenses	12,676	1,435	14,111	10,876	1,649	12,525
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES	(1,036)	69	(967)	2,360	46	2,406
Income tax expense (benefit)	(356)	25	(331)	846	14	860
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES	(680)	44	(636)	1,514	32	1,546
Equity in earnings of operating joint ventures, net of taxes	45	0	45	67	0	67
INCOME (LOSS) FROM CONTINUING OPERATIONS	(635)	44	(591)	1,581	32	1,613
Income (loss) from discontinued operations, net of taxes	(1)	(1)	(2)	(9)	0	(9)

NET INCOME (LOSS)	(636)	43	(593)	1,572	32	1,604
Less: Income attributable to noncontrolling interests	25	0	25	10	0	10
NET INCOME (LOSS) ATTRIBUTABLE TO PRUDENTIAL FINANCIAL, INC.	$ (661)	$ 43	$ (618)	$ 1,562	$ 32	$ 1,594

See Notes to Unaudited Interim Supplemental Combining Financial Information

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PRUDENTIAL FINANCIAL, INC.

Unaudited Interim Supplemental Combining Statements of Operations

Nine Months Ended September 30, 2012 and 2011 (in millions)

	Nine Months Ended September 30, 2012			2011		
	Financial Services Businesses	Closed Block Business	Consolidated	Financial Services Businesses	Closed Block Business	Consolidated
REVENUES						
Premiums	$ 21,297	$ 2,059	$ 23,356	$ 15,735	$ 2,129	$ 17,864
Policy charges and fee income	3,335	0	3,335	2,911	0	2,911
Net investment income	7,757	2,354	10,111	7,376	2,402	9,778
Asset management fees and other income	3,141	26	3,167	3,816	30	3,846
Realized investment gains (losses), net:						
Other-than-temporary impairments on fixed maturity securities	(799)	(546)	(1,345)	(1,004)	(602)	(1,606)
Other-than-temporary impairments on fixed maturity securities transferred to Other Comprehensive Income	561	484	1,045	695	538	1,233
Other realized investment gains (losses), net	(1,046)	280	(766)	2,770	549	3,319
Total realized investment gains (losses), net	(1,284)	218	(1,066)	2,461	485	2,946
Total revenues	34,246	4,657	38,903	32,299	5,046	37,345
BENEFITS AND EXPENSES						
Policyholders’ benefits	20,881	2,565	23,446	15,119	2,557	17,676
Interest credited to policyholders’ account balances	3,167	103	3,270	3,373	104	3,477
Dividends to policyholders	109	1,454	1,563	113	1,848	1,961
Amortization of deferred policy acquisition	1,165	29	1,194	2,347	28	2,375
General and administrative expenses	7,855	409	8,264	7,320	418	7,738
Total benefits and expenses	33,177	4,560	37,737	28,272	4,955	33,227
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES	1,069	97	1,166	4,027	91	4,118
Income tax expense	536	36	572	1,285	27	1,312
INCOME FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES	533	61	594	2,742	64	2,806
Equity in earnings of operating joint ventures, net of taxes	58	0	58	181	0	181
INCOME FROM CONTINUING OPERATIONS	591	61	652	2,923	64	2,987
Income (Loss) from discontinued operations, net of taxes	14	(2)	12	21	0	21
NET INCOME	605	59	664	2,944	64	3,008
Less: Income attributable to noncontrolling interests	51	0	51	64	0	64

NET INCOME ATTRIBUTABLE TO PRUDENTIAL FINANCIAL, INC.	$ 554	$ 59	$ 613	$ 2,880	$ 64	$ 2,944

See Notes to Unaudited Interim Supplemental Combining Financial Information

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Supplemental Combining Financial Information

1. BASIS OF PRESENTATION

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

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

The Closed Block Business was established on the date of demutualization and includes the assets and liabilities of the Closed Block (see Note 6 to the Unaudited Interim Consolidated Financial Statements for a description of the Closed Block). It also includes assets held outside the Closed Block necessary to meet insurance regulatory capital requirements related to products included within the Closed Block; deferred policy acquisition costs related to the Closed Block policies; the principal amount of the IHC debt (as discussed below) and related unamortized debt issuance costs, as well as an interest rate swap related to the IHC debt; and certain other related assets and liabilities. The Financial Services Businesses consist of the U.S. Retirement Solutions and Investment Management, U.S. Individual Life and Group Insurance, and International Insurance divisions and Corporate and Other operations.

2. ALLOCATION OF RESULTS

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

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

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

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Supplemental Combining Financial Information—(Continued)

Income taxes are allocated between the Financial Services Businesses and the Closed Block Business as if they were separate companies based on the taxable income or losses and other tax characterizations of each business. If a business generates benefits, such as net operating losses, it is entitled to record such tax benefits to the extent they are expected to be utilized on a consolidated basis.

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

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

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

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ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) addresses the consolidated financial condition of Prudential Financial as of September 30, 2012, compared with December 31, 2011, and its consolidated results of operations for the three and nine months ended September 30, 2012 and 2011. You should read the following analysis of our consolidated financial condition and results of operations in conjunction with the MD&A, the “Risk Factors” section, and the audited Consolidated Financial Statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011, as well as the statements under “Forward-Looking Statements” and the Unaudited Interim Consolidated Financial Statements included elsewhere in this Quarterly Report on Form 10-Q.

Overview

Prudential Financial has two classes of common stock outstanding. The Common Stock, which is publicly traded (NYSE:PRU), reflects the performance of the Financial Services Businesses, while the Class B Stock, which was issued through a private placement and does not trade on any exchange, reflects the performance of the Closed Block Business. The Financial Services Businesses and the Closed Block Business are discussed below.

Financial Services Businesses

Our Financial Services Businesses consist of three operating divisions, which together encompass six segments, and our Corporate and Other operations. The U.S. Retirement Solutions and Investment Management division consists of our Individual Annuities, Retirement and Asset Management segments. The U.S. Individual Life and Group Insurance division consists of our Individual Life and Group Insurance segments. The International Insurance division consists of our International Insurance segment. Our Corporate and Other operations include corporate items and initiatives that are not allocated to business segments, as well as businesses that have been or will be divested.

We attribute financing costs to each segment based on the amount of financing used by each segment, excluding financing costs associated with corporate debt which are reflected in Corporate and Other operations. The net investment income of each segment includes earnings on the amount of capital that management believes is necessary to support the risks of that segment.

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

Closed Block Business

In connection with the demutualization, we ceased offering domestic participating products. The liabilities for our traditional domestic in force participating products were segregated, together with assets, in a regulatory mechanism referred to as the “Closed Block.” The

Closed Block is designed generally to provide for the reasonable expectations for future policy dividends after demutualization of holders of participating individual life insurance policies and annuities included in the Closed Block by allocating assets that will be used exclusively for payment of benefits, including policyholder dividends, expenses and taxes with respect to these products. See Note 6 to the Unaudited Interim Consolidated Financial Statements and “Business—Demutualization and Separation of the Businesses” in our 2011 Annual Report on Form 10-K for more information on the Closed Block.

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Executive Summary

Prudential Financial, a financial services leader with approximately $1.005 trillion of assets under management as of September 30, 2012, has operations in the United States, Asia, Europe and Latin America. Through our subsidiaries and affiliates, we offer a wide array of financial products and services, including life insurance, annuities, retirement-related services, mutual funds and investment management. We offer these products and services to individual and institutional customers through one of the largest distribution networks in the financial services industry.

Effective January 1, 2012, the Company adopted the amended authoritative guidance issued by the FASB to address which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral. The Company has applied the retrospective method of adoption. Accordingly, all financial information presented has been revised to reflect the retrospective adoption of the amended guidance. For further information, see “—Accounting Policies and Pronouncements—Adoption of New Accounting Pronouncements.”

On June 1, 2012, we announced the signing of an agreement with General Motors Co., pursuant to which we would assume certain of its pension benefit obligations to U.S. salaried retiree plan participants and beneficiaries that are covered by the agreement. At closing on November 1, 2012, we issued a group annuity contract to the General Motors Salaried Pension Trust, and assumed responsibility for providing specified benefits to certain participants. In addition, on October 17, 2012, we signed an agreement with Verizon Communications Inc., pursuant to which we will assume certain of its pension benefit obligations to U.S. salaried retiree plan participants and beneficiaries that are covered by the agreement. Upon fulfillment of certain conditions and closing, which are expected to occur in December 2012, we will issue a group annuity contract to the Verizon Management Pension Plan, and will assume responsibility for making payments to participants who retired and started receiving pension benefits before January 1, 2010. These pension risk transfer transactions significantly expand the size of our existing payout annuity business.

On June 12, 2012, Prudential Financial’s Board of Directors authorized the Company to repurchase at management’s discretion up to $1.0 billion of its outstanding Common Stock during the period from July 1, 2012 through June 30, 2013. As of September 30, 2012, 2.7 million shares of our Common Stock were repurchased under this authorization for a total cost of $150 million. The timing and amount of any share repurchases will be determined by management based upon market conditions and other considerations, and such repurchases may be effected in the open market, through derivative, accelerated repurchase and other negotiated transactions and through prearranged trading plans designed to comply with Rule 10b5-1(c) under the Exchange Act. The Company exhausted all of the $1.5 billion share repurchase authorization established in June 2011.

In July 2012, we announced our decision to cease sales of group long-term care insurance reflecting the challenging economics of the long-term care market including the continued low interest rate environment as well as our desire to focus our resources on our core group life and disability businesses. We discontinued sales of group long-term care products effective August 1, 2012, or a later date as may be required by specific state law. We notified our clients of our intent to continue to accept enrollments on existing group long-term care contracts through June 30, 2013 or later as required by contractual provisions. In March 2012, we also discontinued sales of our individual long-term care products. As a result of our decision to wind down this business, we have reflected the results of the long-term care insurance business, previously reported within the Group Insurance segment, as a divested business for all periods presented.

On September 27, 2012, we announced that Prudential Insurance agreed to acquire The Hartford’s Individual Life Insurance Business through a reinsurance transaction. Under the terms of the agreement, we will pay $615 million, primarily in the form of a ceding commission to provide reinsurance for approximately 700,000 life insurance policies with net retained face amount in force of approximately $135 billion. We expect to close the transaction in early 2013, subject to regulatory approvals and customary closing conditions.

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On October 19, 2012, Prudential Financial received notice that it is under consideration by the Financial Stability Oversight Council (the “Council”) for a proposed determination that it should be subject to stricter prudential regulatory standards and supervision by the Board of Governors of the Federal Reserve System pursuant to the Dodd-Frank Act (a “Covered Company”). The notice of consideration indicates that Prudential Financial is being reviewed in stage 3 of the three-stage process described in the Council’s interpretative guidance for Covered Company determinations and does not constitute a notice of a proposed determination. The Company is entitled, under the applicable regulations, to contest such consideration. We intend to continue our discussions with regulators about the differences between banks and insurance companies as they consider which companies should be designated. Nevertheless, the Council may determine to issue to Prudential Financial a written notice of determination that it is a Covered Company, in which event we would be entitled to request a nonpublic evidentiary hearing before the Council. The prudential standards under the Dodd-Frank Act include requirements regarding risk-based capital and leverage, liquidity, stress-testing, overall risk management, resolution plans, early remediation, and credit concentration; and may also include additional standards regarding capital, public disclosure, short-term debt limits, and other related subjects as appropriate. See “Business—Regulation” and “Risk Factors” in our 2011 Annual Report on Form 10-K for more information regarding the potential impact of the Dodd-Frank Act on the Company, including as a result of these stricter prudential standards.

Prudential Bank & Trust, FSB has limited its operations to trust services. On October 31, 2012, the Board of Governors of the Federal Reserve System approved Prudential Financial’s application to deregister as a savings and loan holding company, effective as of that date.

On November 7, 2012, Prudential Financial declared an annual dividend for 2012 of $1.60 per share of Common Stock, reflecting an increase of approximately 10% from the 2011 Common Stock dividend. The Company also announced that it will move to a quarterly Common Stock dividend schedule beginning in the first quarter of 2013.

Impact of Low Interest Rate Environment

The low interest rate environment in the U.S. has resulted in our current reinvestment yields being lower than the overall portfolio income yield, primarily for our investments in fixed maturity securities and commercial mortgage loans. With the Federal Reserve Board’s decision to keep interest rates low through at least 2014, our portfolio income yields are expected to continue to decline in future periods.

Within our domestic Financial Services Businesses, financial results of business with long-duration contracts with fixed and guaranteed crediting rates, or floors that limit crediting rate reductions are most impacted by a prolonged low interest rate environment. Also impacted are financial results of business with long duration products that do not have stated crediting rate guarantees but for which underlying assets may have to be reinvested at interest rates that are lower than portfolio rates, such as group annuities, structured settlements and term insurance.

For the domestic Financial Services Businesses’ general account, we expect approximately 10% of the fixed maturity securities and commercial mortgage loans to mature annually through 2014. The domestic Financial Services Businesses’ general account has approximately $123 billion of such assets (based on net carrying value) as of September 30, 2012. As these assets mature, the current average portfolio income yield for fixed maturities and commercial mortgage loans of approximately 5% is expected to decline due to reinvesting in a lower interest rate environment.

Our disciplined approach in our asset-liability management, which includes our duration management and crediting rate strategies, has helped mitigate the unfavorable impact that the current interest rate environment has on our net interest margins for our domestic Financial Services Businesses. Our interest rate exposure is also mitigated by our business mix, as we have relatively limited exposure to lines of business in which net interest

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margin plays a more prominent role in product profitability. These lines of business include long-term care, fixed annuities and universal life, which represents a limited portion of our individual life business in force. In addition, within our Retirement business, a substantial portion of our stable value account values have very low crediting rate floors.

Our Japanese insurance operations have experienced a prolonged low interest rate environment for many years. These operations issue recurring payment and single premium products that are denominated in both Japanese yen and U.S. dollars, as well as fixed annuity products that are denominated in U.S. dollars. For the Japanese yen-denominated products, the exposure to decreased interest rates is limited as our Japanese insurance operations have considered the prolonged low interest rate environment in product pricing, and a rigorous asset-liability management program, which includes our duration management and crediting rate strategies, further limits our exposure. For the U.S. dollar-denominated recurring payment products, our exposure to low interest rates in the U.S. is also limited by our asset-liability management program. For the U.S. dollar-denominated single premium and fixed annuity products, the risk of reduced interest rates is limited, as new fixed annuity contracts are re-priced frequently and pricing for other products is reviewed and updated regularly to reflect current market interest rates.

Performance Highlights

Net loss of our Financial Services Businesses attributable to Prudential Financial, Inc. for the three months ended September 30, 2012 was $661 million, compared to net income of $1,562 million for the three months ended September 30, 2011. Net income of our Financial Services Businesses attributable to Prudential Financial, Inc. for nine months ended September 30, 2012 and 2011 was $554 million and $2,880 million, respectively.

Pre-tax adjusted operating income for the Financial Services Businesses for the three and nine months ended September 30, 2012 was $982 million and $2,808 million, respectively, compared to $509 million and $2,642 million for the three and nine months ended September 30, 2011, respectively. See below under “Results of Operations” for a discussion of adjusted operating income.

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Our financial condition and results of operations as of and for the three and nine months ended September 30, 2012 and 2011 reflect the following:

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(in millions)			
Individual Annuities:				
Gross sales	$ 5,926	$ 4,487	$ 16,243	$ 15,871
Net flows	3,961	2,479	10,181	9,194
Account values (at end of period)			132,705	106,689
Retirement:				
Full Service:				
Gross deposits and sales	$ 3,478	$ 3,966	$ 12,487	$ 12,942
Net additions (withdrawals)	(585)	(160)	(2,350)	(325)
Account values (at end of period)			146,934	134,198
Institutional Investment Products:				
Gross sales	$ 2,957	$ 5,571	$ 15,813	$ 16,948
Net additions (withdrawals)	1,418	4,070	9,904	12,882
Account values (at end of period)			104,646	80,513
Asset Management:				
Gross additions(1)	$ 19,200	$ 16,800	$ 61,700	$ 51,100
Net flows(1)	5,100	2,600	17,500	15,300
Assets under management (at end of period)			670,200	599,400
International Insurance:				
Annualized new business premiums(2)	$ 900	$ 810	$ 2,846	$ 2,241
Individual Life:				
Annualized new business premiums	$ 98	$ 70	$ 268	$ 203
Group Insurance:				
Annualized new business premiums	$ 46	$ 40	$ 381	$ 566

(1) Includes third party institutional and retail activity. Excludes money market activity.
(2) On a constant exchange rate basis.

Results of Operations

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

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Shown below are the contributions of each segment and Corporate and Other operations to our adjusted operating income for the three and nine months ended September 30, 2012 and 2011 and a reconciliation of adjusted operating income of our segments and Corporate and Other operations to income from continuing operations before income taxes and equity in earnings of operating joint ventures. Results for the nine months ended September 30, 2012 reflect the impact of two adjustments related to prior periods. For further information, see Note 1 to the Unaudited Interim Consolidated Financial Statements.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Adjusted operating income before income taxes for segments of the Financial Services Businesses:				
Individual Annuities	$ 207	$ (192)	$ 735	$ 289
Retirement	110	111	413	454
Asset Management	187	123	356	504
Total U.S. Retirement Solutions and Investment Management Division	504	42	1,504	1,247
Individual Life	112	111	285	344
Group Insurance	35	45	28	121
Total U.S. Individual Life and Group Insurance Division	147	156	313	465
International Insurance	783	660	2,070	1,788
Total International Insurance Division	783	660	2,070	1,788
Corporate and Other	(452)	(349)	(1,079)	(858)
Adjusted operating income before income taxes for the Financial Services Businesses	982	509	2,808	2,642
Reconciling Items:				
Realized investment gains (losses), net, and related adjustments	(1,951)	3,385	(1,609)	3,175
Charges related to realized investment gains (losses), net	648	(1,568)	498	(1,732)
Investment gains on trading account assets supporting insurance liabilities, net	264	10	502	170
Change in experience-rated contractholder liabilities due to asset value changes	(254)	68	(446)	(76)
Divested businesses	(685)	43	(657)	49
Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests	(40)	(87)	(27)	(201)
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures for Financial Services Businesses	(1,036)	2,360	1,069	4,027
Income (loss) from continuing operations before income taxes for Closed Block Business	69	46	97	91
Consolidated income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures	$ (967)	$ 2,406	$ 1,166	$ 4,118

Results for the three and nine months ended September 30, 2012 presented above reflect the following:

- • Individual Annuities segment results for the third quarter and first nine months of 2012 increased in comparison to the prior year periods, primarily reflecting a favorable comparative impact from adjustments to the estimated profitability of the business. These adjustments were driven by the net impacts of market performance, and annual reviews and updates of economic and actuarial assumptions

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and other refinements. Excluding these items, the increases reflect higher asset-based fee income, primarily due to higher average variable annuity account values, net of an increased level of distribution and amortization costs, partially offset by higher general and administrative expenses, net of capitalization.

• Retirement segment results for the third quarter and first nine months of 2012 decreased in comparison to the prior year periods. The decrease in both periods includes the impact of a charge in the third quarter of 2012 resulting from the write off of an intangible asset related to an acquired business, partially offset by favorable comparative impacts from adjustments to the amortization of deferred policy acquisition costs and the value of business acquired. These adjustments were primarily driven by the impacts on the estimated profitability of the business based on an annual review and update of economic and actuarial assumptions. The decrease for the first nine months of 2012 also reflects costs incurred related to the divestiture of bank deposits previously held by Prudential Bank & Trust, FSB as a result of our decision to limit its operations to trust services. Excluding these items, results for the third quarter of 2012 increased in comparison to the prior year period, and results for the first nine months of 2012 decreased in comparison to the prior year period. The increase for the third quarter of 2012 compared to the prior year period primarily reflects higher net investment spread results and higher asset-based fee income, partially offset by an unfavorable comparative reserve impact from case experience. The decrease for the first nine months of 2012 compared to the prior year period primarily reflects lower net investment spread results and an unfavorable comparative reserve impact from case experience, partially offset by higher asset-based fee income and lower general and administrative expenses, net of capitalization.

• Asset Management segment results for the third quarter of 2012 increased in comparison to the third quarter of 2011 primarily from a greater contribution from the segment’s incentive, transaction, strategic investing and commercial mortgage activities. Current quarter results also benefited from higher asset management fees reflecting growth in assets under management, net of expenses. Asset Management segment results decreased in the first nine months of 2012 compared to the first nine months of 2011 primarily due to a lower contribution from the segment’s incentive, transaction, strategic investing and commercial mortgage activities, which reflected a charge in the current year for an impairment of a real estate-related investment, compared to a gain in the prior year on the partial sale of a real estate seed investment. The lower contribution from these activities, as well as higher expenses in the current year offset the benefit from higher asset management fees.

• Individual Life segment results for the third quarter of 2012 were relatively unchanged from the third quarter of 2011, and results for the first nine months of 2012 decreased in comparison to the first nine months of 2011. Results for both periods reflect unfavorable comparative impacts from adjustments to the amortization of deferred policy acquisition costs and unearned revenue reserves and to the reserves for the guaranteed minimum death benefit feature in certain contracts. These adjustments were primarily driven by the impact of certain changes in our estimated profitability of the business related to our annual review and update of economic and actuarial assumptions. Excluding these items, results for the third quarter of 2012 increased from the third quarter of 2011, driven by improved mortality experience, and results decreased for the nine month comparative period primarily reflecting more unfavorable mortality experience. Both the three month and nine month periods benefited from favorable equity markets on separate account fund performance.

• Group Insurance segment results decreased in both the third quarter and first nine month of 2012 compared to prior year periods. Results for both periods reflect unfavorable comparative variances from reserve refinements, including the impact of annual actuarial assumption updates. Excluding these items, results for the third quarter of 2012 increased from the third quarter of 2011 driven by improved investment income, partly offset by less favorable group life claims experience, while results decreased for the first nine months of 2012 compared to the prior year period reflecting less favorable group disability and group life underwriting results and higher expenses, including an unfavorable comparative impact for updates to premium tax estimates.

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- • International Insurance segment results for the third quarter of 2012 improved from the third quarter of 2011. Results from the segment’s Life Planner operations improved in the current period, primarily reflecting business growth, the favorable impact from our annual review and update of assumptions used in estimating the profitability of our business and a net favorable impact from foreign currency exchange rates including the impact of the Company’s currency hedging programs. Results from the segment’s Gibraltar Life and Other operations also improved in the current year quarter primarily driven by business growth, greater cost savings from business integration synergies associated with the acquisition of the Star and Edison businesses, and a net favorable impact from foreign currency exchange rates. Offsetting these items was a greater benefit in the year-ago quarter than the current quarter from partial sales of our indirect interest in China Pacific Group. International Insurance segment results increased in the first nine months of 2012 in comparison to the prior year period. Results from the segment’s Life Planner operations reflect the impact of continued business growth, the favorable impact from our annual review and update of assumptions used in estimating the profitability of our business and a net favorable impact from foreign currency exchange rates. Improved results from the segment’s Gibraltar Life and Other operations reflect business growth, greater cost savings from business integration synergies, and the absence of claims and expenses associated with the 2011 earthquake in Japan. Offsetting these favorable items was a greater benefit in the year-ago period than the 2012 period from partial sales of our indirect investment in China Pacific Group.

- • Corporate and Other operations resulted in an increased loss both for the third quarter of 2012 and the first nine months of 2012 compared to prior year periods reflecting higher levels of expenses in other corporate activities, greater interest expense, net of investment income, driven mainly by higher levels of capital debt and a lower contribution from income from our qualified pension plan.

- • Income from continuing operations before income taxes in the Closed Block Business for the third quarter and first nine months of 2012 increased in comparison to the prior year periods. The increase in the third quarter of 2012, compared to the third quarter of 2011 primarily reflects a benefit from a lower increase in the cumulative policyholder dividend obligation expense, as well as a lower increase in reserves for estimated payments arising from the use of new Social Security Master Death File matching criteria to identify deceased policy and contract holders, partially offset by a decrease in net realized investment gains. The increase in the first nine months of 2012, compared to the first nine months of 2011 also reflects a benefit from a lower increase in the cumulative policyholder dividend obligation expense, partially offset by a decrease in net realized investment gains and an increase in the change in reserves for estimated payments arising from the use of new Social Security Master Death File matching criteria to identify deceased policy and contract holders.

Accounting Policies & Pronouncements

Application of Critical Accounting Estimates

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

Management believes the accounting policies relating to the following areas are most dependent on the application of estimates and assumptions and require management’s most difficult, subjective, or complex judgments:

- • Deferred policy acquisition and other costs, including value of business acquired;

• Goodwill;

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• Valuation of investments, including derivatives, and the recognition of other-than-temporary impairments;

• Policyholder liabilities;

• Pension and other postretirement benefits;

• Taxes on income; and

• Reserves for contingencies, including reserves for losses in connection with unresolved legal matters.

In the first quarter of 2012, we revised the treatment of the results of the living benefits hedging program in our best estimate of total gross profits used to calculate the amortization of deferred policy acquisition costs (“DAC”) and deferred sales inducements (“DSI”) associated with certain of the variable annuity contracts of our Individual Annuities segment. In 2011, we included the difference between the change in the fair value of hedge positions and the change in the value of the hedge target liability, excluding the unhedged portion, in our best estimate of gross profits used to determine amortization rates only to the extent this net amount was determined by management to be other-than-temporary. Beginning with the first quarter of 2012, we are including these impacts in our best estimate of total gross profits used for determining amortization rates each quarter without regard to the permanence of the changes. The current period impact of resetting the amortization rates for this item is discussed within “—Results of Operations for Financial Services Businesses by Segment—U.S. Retirement Solutions and Investment Management Division—Individual Annuities—Net impact of optional living benefit guarantees and related hedge positions.” For a discussion of the unhedged portion, which represents the impact of temporarily hedging to an amount that differs from our hedge target based on the overall capital considerations of the Company and prevailing capital market conditions, see “—Corporate & Other.”

Additionally, in the third quarter of each year, we perform an annual comprehensive review and update of the assumptions used in estimating gross profits for future periods. The near-term future rate of return assumptions used in evaluating DAC and DSI for our domestic variable annuity and variable life insurance products are derived using a reversion to the mean approach, a common industry practice. Under this approach, we consider the actual historical economic returns over a period of time and initially adjust future projected returns over the next four years (the “near-term”) so that the assets are projected to grow at the long-term expected rate of return for the entire period. If the near-term projected future rate of return is greater than our near-term maximum future rate of return, we use our maximum future rate of return.

As of September 30, 2012, our variable annuities business utilizes distinct rates of return for equity and fixed income investments. Assumptions for this business reflect an 8.0% long-term equity expected rate of return and a near-term mean reversion equity rate of return of 8.5%. As of September 30, 2012, all contract groups within our variable annuities business utilized these rates, as the near-term mean reversion equity rate of return was less than our 13% maximum. Fixed income expected rates of return include a risk free return plus a credit spread and consider the duration and credit profile of the respective bond funds. Fixed income returns reflect a grading from current rates up to long term rates over a ten year period. The weighted average fixed income expected rate of return after the ten year grading period is 5.4%.

As of September 30, 2012, our variable life insurance business utilizes blended rates of return, which are based on a long-term expected distribution of funds between equity and fixed income funds. Assumptions for this business reflect a long-term blended expected rate of return of 6.5%, which includes an 8.1% long-term equity expected rate of return and a 4.5% fixed income expected rate of return. The 4.5% fixed income expected rate of return is a levelized rate, which blends current rates and long-term expected returns. Assumptions also reflect a near-term mean reversion blended rate of return of 5.8%. As of September 30, 2012, all contract groups within our variable life insurance business utilize these rates, as the near-term equity rate of return was less than our 13% maximum.

The weighted average rate of return assumptions for these businesses consider many factors specific to each business, including asset durations, asset allocations and other factors. We update the near term rates of return and our estimate of total gross profits each quarter to reflect the result of the reversion to the mean approach,

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which assumes a convergence to the long-term expected rates of return. These market performance related adjustments to our estimate of total gross profits result in cumulative adjustments to prior amortization, reflecting the application of the new required rate of amortization to all prior periods’ gross profits. The new required rate of amortization is also applied prospectively to future gross profits in calculating amortization in future periods.

Additional information on our policies for our critical accounting estimates listed above may be found in our Annual Report on Form 10-K for the year ended December 31, 2011, under “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Accounting Policies & Pronouncements—Application of Critical Accounting Estimates.”

Adoption of New Accounting Pronouncements

In October 2010, the FASB issued authoritative guidance to address which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral. The Company adopted this guidance effective January 1, 2012, and applied the retrospective method of adoption. Accordingly, prior period financial information has been adjusted to reflect the retrospective adoption of the amended guidance. The impact of the retrospective adoption of this guidance on previously reported December 31, 2011 balances was a reduction in deferred policy acquisition costs by $4.1 billion for the Financial Services Businesses and by $0.2 billion for the Closed Block Business, an increase in policy reserves for certain limited pay contracts by $0.2 billion for the Financial Services Businesses, and a reduction in total equity by $2.8 billion for the Financial Services Businesses and by $0.2 billion for the Closed Block Business. The impact of the retrospective adoption of this guidance on previously reported income from continuing operations before income taxes for the three and nine months ended September 30, 2011 was an increase of $68 million and a decrease of $105 million for the Financial Services Businesses, respectively, and an increase of $4 million and $13 million for the Closed Block Business, respectively. The lower level of costs now qualifying for deferral will be only partially offset by a lower level of amortization of deferred policy acquisition costs, and, as such, will initially result in lower earnings in future periods, primarily within the International Insurance and Individual Annuities segments. The impact to the International Insurance segment largely reflects lower deferrals of allocated costs of its proprietary distribution system, while the impact to the Individual Annuities segment mainly reflects lower deferrals of its wholesaler costs. While the adoption of this amended guidance changes the timing of when certain costs are reflected in the Company’s results of operations, it has no effect on the total acquisition costs to be recognized over time and has no impact on the Company’s cash flows.

See Note 2 to our Unaudited Interim Consolidated Financial Statements for a discussion of newly adopted accounting pronouncements, including further discussion of the new authoritative guidance addressing which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral.

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Consolidated Results of Operations

The following table summarizes net income for the Financial Services Businesses and the Closed Block Business for the periods presented.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Financial Services Businesses:				
Revenues	$ 11,640	$ 13,236	$ 34,246	$ 32,299
Benefits and expenses	12,676	10,876	33,177	28,272
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures for Financial Services Businesses	(1,036)	2,360	1,069	4,027
Income tax expense (benefit)	(356)	846	536	1,285
Income (loss) from continuing operations before equity in earnings of operating joint ventures for Financial Services Businesses	(680)	1,514	533	2,742
Equity in earnings of operating joint ventures, net of taxes	45	67	58	181
Income (loss) from continuing operations for Financial Services Businesses	(635)	1,581	591	2,923
Income (loss) from discontinued operations, net of taxes	(1)	(9)	14	21
Net income (loss)—Financial Services Businesses	(636)	1,572	605	2,944
Less: Income attributable to noncontrolling interests	25	10	51	64
Net income (loss) of Financial Services Businesses attributable to Prudential Financial, Inc.	$ (661)	$ 1,562	$ 554	$ 2,880
Closed Block Business:				
Revenues	$ 1,504	$ 1,695	$ 4,657	$ 5,046
Benefits and expenses	1,435	1,649	4,560	4,955
Income from continuing operations before income taxes for Closed Block Business	69	46	97	91
Income tax expense	25	14	36	27
Income from continuing operations for Closed Block Business	44	32	61	64
Income (loss) from discontinued operations, net of taxes	(1)	0	(2)	0
Net income—Closed Block Business	43	32	59	64
Less: Income attributable to noncontrolling interests	0	0	0	0
Net income of Closed Block Business attributable to Prudential Financial, Inc.	$ 43	$ 32	$ 59	$ 64
Consolidated:				
Net income (loss) attributable to Prudential Financial, Inc.	$ (618)	$ 1,594	$ 613	$ 2,944

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Results of Operations—Financial Services Businesses

2012 to 2011 Three Month Comparison. Income (loss) from continuing operations for the Financial Services Businesses decreased $2,216 million, from income of $1,581 million in the third quarter of 2011 to a loss of $635 million in the third quarter of 2012. Results for the third quarter of 2012 compared to the third quarter of 2011 reflect the following:

• Lower net pre-tax earnings of $1,663 million resulting from the impact of foreign currency exchange rate movements on certain non-yen denominated assets and liabilities within our Japanese insurance operations, for which we economically hedge the foreign currency exposure, driven by the weakening of the yen against the Australian dollar in the third quarter of 2012 compared to a strengthening of the Japanese yen against the Australian and U.S. dollar in the prior year period;

• $806 million lower net pre-tax realized gains (losses), excluding the impact of the hedging program associated with certain variable annuities as described below, primarily reflecting lower gains from changes in the market value of derivatives used to manage duration in our general account investment portfolios as a result of changes in interest rates. Also contributing to the decline is the comparative impact of losses in the third quarter of 2012 compared to gains in the year-ago quarter resulting from changes in the market value of currency derivatives due to foreign currency exchange rate movements;

• A $721 million unfavorable variance, before income taxes, reflecting the net impact from market value changes on our embedded derivatives and related hedge positions associated with certain variable annuities, primarily driven by the impact of non-performance risk, partially offset by the impact of amortization of deferred policy acquisition and other costs as well as market value changes associated with derivatives under our capital hedge program; and

• A $693 million unfavorable variance, before taxes, from adjustments to deferred policy acquisition and other costs and the reserves for our long-term care products, reflecting updates to the estimated profitability of the business, driven by reductions to our long-term interest rate assumptions and updates to our morbidity assumptions, partially offset by expected future premium increases.

Partially offsetting these decreases in income from continuing operations were the following items:

• A $1,202 decrease in income tax expense primarily reflecting the decline in pre-tax income from continuing operations; and

• A $373 million favorable variance, before taxes, from adjustments to deferred policy acquisition and other costs and the reserves for guaranteed minimum death and income benefit features of our variable annuity products, reflecting updates to the estimated profitability of the business, primarily resulting from market performance and the impact of an annual review and update of assumptions.

2012 to 2011 Nine Month Comparison. Income from continuing operations for the Financial Services Businesses decreased $2,332 million, from $2,923 million in the first nine months of 2011 to $591 million in the first nine months of 2012. Results for the first nine months of 2012 compared to the first nine months of 2011 reflect the following:

• Lower net pre-tax earnings of $1,316 million resulting from the impact of foreign currency exchange rate movements on certain non-yen denominated assets and liabilities within our Japanese insurance operations, for which we economically hedge the foreign currency exposure, driven by the weakening of the Japanese yen;

• A $885 million unfavorable variance, before income taxes, reflecting the net impact from market value changes on our embedded derivatives and related hedge positions associated with certain variable annuities, primarily driven by the impact of non-performance risk, partially offset by the impact of amortization of deferred policy acquisition and other costs as well as market value changes associated with derivatives under our capital hedge program;

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• A $693 million unfavorable variance, before taxes, from adjustments to deferred policy acquisition and other costs and the reserves for our long-term care products, reflecting updates to the estimated profitability of the business, driven by reductions to our long-term interest rate assumptions and updates to our morbidity assumptions, partially offset by expected future premium increases;

• Lower net pre-tax realized gains (losses) of $575 million, excluding the impact of the hedging program associated with certain variable annuities as described above, primarily reflecting lower gains from changes in the market value of derivatives used to manage duration in our general account investment portfolios as a result of changes in interest rates. Also contributing to the decline is the comparative impact of changes in the market value of currency derivatives due to foreign currency exchange rate movements; and

• The comparative impact of a $237 million pre-tax benefit in 2011 compared to a pre-tax benefit of $60 million in 2012 reflecting partial sales of our indirect interest in China Pacific Insurance Group.

Partially offsetting these decreases in income from continuing operations were the following items:

• A decrease in income tax expense of $749 million reflecting the decrease in pre-tax income from continuing operations, partly offset by the comparative impact of a $343 million tax expense in 2012 compared to a $240 million expense in 2011 relating to realization of a portion of the local deferred tax assets existing on the opening day balance sheet for the Star and Edison Businesses;

• A $422 million favorable variance, before taxes, from adjustments to deferred policy acquisition and other costs and the reserves for guaranteed minimum death and income benefit features of our variable annuity products, reflecting updates to the estimated profitability of the business, primarily resulting from market performance and the impact of an annual review and update of assumptions; and

• A net increase in premiums and policy charges and fee income, net of an increase in policyholders’ benefits, including changes in reserves, primarily reflecting business growth, as well as the impact of currency fluctuations, in our International Insurance operations.

Results of Operations—Closed Block Business

For a discussion of the results of operations for the Closed Block Business, see “—Results of Operations of Closed Block Business,” below.

Segment Measures

In managing our business, we analyze operating performance separately for our Financial Services Businesses and our Closed Block Business. For the Financial Services Businesses, we analyze our segments’ operating performance using “adjusted operating income.” Results of the Closed Block Business for all periods are evaluated and presented only in accordance with U.S. GAAP. Adjusted operating income does not equate to “income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures” or “net income” as determined in accordance with U.S. GAAP but is the measure of segment profit or loss we use to evaluate segment performance and allocate resources, and consistent with authoritative guidance, is our measure of segment performance. The adjustments to derive adjusted operating income are important to an understanding of our overall results of operations. Adjusted operating income is not a substitute for income determined in accordance with U.S. GAAP, and our definition of adjusted operating income may differ from that used by other companies. However, we believe that the presentation of adjusted operating income as we measure it for management purposes enhances understanding of our results of operations by highlighting the results from ongoing operations and the underlying profitability of the Financial Services Businesses.

See Note 11 to the Unaudited Interim Consolidated Financial Statements for further information on the presentation of segment results and our definition of adjusted operating income.

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Results of Operations for Financial Services Businesses by Segment

U.S. Retirement Solutions and Investment Management Division

Individual Annuities

Operating Results

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Operating results:				
Revenues	$ 1,018	$ 905	$ 2,944	$ 2,736
Benefits and expenses	811	1,097	2,209	2,447
Adjusted operating income	207	(192)	735	289
Realized investment gains (losses), net, and related adjustments(1)	(1,491)	3,084	(1,101)	3,387
Related charges(2)	682	(1,609)	550	(1,774)
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures	$ (602)	$ 1,283	$ 184	$ 1,902

(1) Revenues exclude Realized investment gains (losses), net, and related adjustments, which include the net impact of optional living benefit guarantees and related hedge positions, as described below. See “—Realized Investment Gains and Losses.”

(2) Revenues exclude charges which represent payments related to the market value adjustment features of certain of our annuity products. Benefits and expenses exclude charges which represent the unfavorable (favorable) impact of Realized investment gains (losses), net, on changes in reserves and the amortization of deferred policy acquisition costs, deferred sales inducements and value of business acquired.

Adjusted Operating Income

2012 to 2011 Three Month Comparison. Adjusted operating income, as reported in the table above, includes the impact of certain changes in our estimated profitability of the business on the reserves for the guaranteed minimum death benefit (“GMDB”) and guaranteed minimum income benefit (“GMIB”) features of our variable annuity products and on the amortization of deferred acquisition costs (“DAC”) and other costs. These items drove a $373 million comparative increase in adjusted operating income, and are discussed in more detail below. Excluding these items, adjusted operating income increased $26 million. This increase was driven by higher asset-based fees due to growth in average variable annuity account values, net of an increased level of distribution and amortization costs. This increase was partially offset by higher general and administrative expenses, net of capitalization, reflecting increased costs to support business expansion. See “—Account Values” below for a further discussion of our account values and sales.

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As noted above, adjusted operating income includes a $373 million comparative increase from the impact of certain changes in our estimated profitability of the business. The following table shows the impact of adjustments for market performance, current quarter experience and the annual review and update of assumptions performed in the third quarter, for the periods indicated.

	Three Months Ended September 30, 2012			Three Months Ended September 30, 2011		
	Amortization of DAC and Other Costs(1)	Reserves for GMDB / GMIB(2)	Total	Amortization of DAC and Other Costs(1)	Reserves for GMDB / GMIB(2)	Total
			(in millions)			
Quarterly adjustments for market performance and current quarter experience	$ 27	$ 31	$ 58	$ (139)	$ (306)	$ (445)
Annual review / assumption updates	221	(327)	(106)	(41)	65	24
Total adjustments for changes in the estimated profitability of the business	$ 248	$ (296)	$ (48)	$ (180)	$ (241)	$ (421)

(1) Amounts reflect (charges) or benefits for (increases) or decreases, respectively, in the amortization of DAC and other costs resulting from adjustments to our estimate of total gross profits.
(2) Amounts reflect (charges) or benefits for reserve (increases) or decreases, respectively, related to the GMDB / GMIB features of our variable annuity products.

The $58 million of net benefits and $445 million of net charges in the third quarter of 2012 and 2011, respectively, were primarily driven by the impact of market performance on customer accounts relative to our assumptions. Actual returns were higher than expected in the third quarter of 2012, which drove positive cumulative impacts to both the amortization of DAC and other costs and the reserves for the GMDB and GMIB features of our variable annuity contracts, and actual returns were lower than expected in the third quarter of 2011, which drove negative cumulative impacts for these items. The $106 million net charge and $24 million net benefit in the third quarter of 2012 and 2011, respectively, relate to our annual review and update of assumptions, and reflect the impact of industry studies and our actual experience. The $106 million net charge in the third quarter of 2012 was driven by the impacts of updates to our economic assumptions, primarily reflecting reductions to our long-term interest and equity rate of return assumptions, as well as updates to actuarial assumptions and other refinements. The $24 million net benefit in the third quarter of 2011 was also driven by the impacts of updates to both economic and actuarial assumptions.

In addition to the current period impacts reflected in the table above, the changes to the estimated profitability of our business will also drive changes in our GMDB and GMIB reserves and the amortization of DAC and other costs in future periods. Additionally, we include certain results of our living benefits hedging program in our best estimate of gross profits used to determine amortization rates, which also drives changes in the amortization of DAC and other costs in future periods. The table above excludes the current period impacts of resetting the amortization rates for this item, as both the results of our living benefits hedging program and related amortization of DAC and other costs are excluded from adjusted operating income, as described in “—Net impact of optional living benefit guarantees and related hedge positions.” However, adjusted operating income in future periods includes the impact on amortization of applying the new rates to actual gross profits. The inclusion of unfavorable results from our living benefits hedging program in the second half of 2011 in our best estimate of gross profits has resulted in higher amortization rates and, therefore, an increase in amortization expense included in adjusted operating income in 2012. While a decrease in our best estimate of total gross profits accelerates amortization and decreases income in a given period, it does not affect our cash flow or liquidity position.

For weighted average rate of return assumptions as of September 30, 2012, see “—Accounting Policies & Pronouncements—Application of Critical Accounting Estimates.” For additional information on our policy for amortizing DAC and other costs, and for estimating future expected claims costs associated with the GMDB and GMIB features of our variable annuity products, see our Annual Report on Form 10-K for the year ended December 31, 2011, under “—Management’s Discussion and Analysis of

Financial Condition and Results of Operations—Accounting Policies & Pronouncements—Application of Critical Accounting Estimates.”

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2012 to 2011 Nine Month Comparison. Adjusted operating income, as reported in the operating results table above, includes the impact of certain changes in our estimated profitability of the business on the reserves for the GMDB and GMIB features of our variable annuity products and on the amortization of DAC and other costs. These items drove a $422 million comparative increase in adjusted operating income, and are discussed in more detail below. Excluding these items, adjusted operating income increased $24 million. This increase was driven by higher asset-based fees due to growth in average variable annuity account values, net of an increased level of distribution and amortization costs. This increase was partially offset by higher general and administrative expenses, net of capitalization, reflecting increased costs to support business expansion. See “—Account Values” below for a further discussion of our account values and sales.

As noted above, adjusted operating income includes a $422 million net increase from the impact of certain changes in our estimated profitability of the business. The following table shows the impact of adjustments for market performance, current quarter experience and the annual review and update of assumptions performed in the third quarter, for the periods indicated.

	Nine Months Ended September 30, 2012			Nine Months Ended September 30, 2011		
	Amortization of DAC and Other Costs(1)	Reserves for GMDB / GMIB(2)	Total	Amortization of DAC and Other Costs(1)	Reserves for GMDB / GMIB(2)	Total
			(in millions)			
Quarterly adjustments for market performance and current quarter experience	$ 53	$ 77	$ 130	$ (136)	$ (286)	$ (422)
Annual review / assumption updates	221	(327)	(106)	(41)	65	24
Total adjustments for changes in the estimated profitability of the business	$ 274	$ (250)	$ 24	$ (177)	$ (221)	$ (398)

(1) Amounts reflect (charges) or benefits for (increases) or decreases, respectively, in the amortization of DAC and other costs resulting from adjustments to our estimate of total gross profits.
(2) Amounts reflect (charges) or benefits for reserve (increases) or decreases, respectively, related to the GMDB / GMIB features of our variable annuity products.

The $130 million net benefit and $422 million net charge in the first nine months of 2012 and 2011, respectively, were primarily driven by the impacts of market performance on customer accounts relative to our assumptions. Overall, actual returns were higher than expected in the first nine months of 2012, which drove positive cumulative impacts to both the amortization of DAC and other costs and the reserves for the GMDB and GMIB features of our variable annuity contracts, and actual returns were lower than expected in the first nine months of 2011, which drove negative cumulative impacts for these items. The $106 million net charge and $24 million net benefit in the first nine months of 2012 and 2011, respectively, relate to our annual review and update of assumptions performed in the third quarter, as discussed above.

Revenues

2012 to 2011 Three Month Comparison. Revenues, as shown in the table above under “—Operating Results,” increased $113 million, from $905 million in the third quarter of 2011 to $1,018 million in the third quarter of 2012, primarily driven by a $114 million increase in policy charges and fee income, and asset management fees and other income, due to growth in average variable annuity account values. See “—Account Values” below for a further discussion of our account values and sales.

2012 to 2011 Nine Month Comparison. Revenues increased $208 million, from $2,736 million in the first nine months of 2011 to $2,944 million in first nine months of 2012, primarily driven by a $235 million increase in policy charges and fee income, and asset management fees and other income, due to growth in average variable annuity account values.

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Benefits and Expenses

2012 to 2011 Three Month Comparison. Benefits and expenses, as shown in the table above under “—Operating Results,” decreased $286 million, from $1,097 million in the third quarter of 2011 to $811 million in the third quarter of 2012. Absent the $373 million net decrease related to the impacts of certain changes in our estimated of profitability of the business, discussed above, benefits and expenses increased $87 million. General and administrative expenses, net of capitalization, increased $61 million, driven by higher asset-based trail commissions, reflecting account value growth, as well as higher costs to support business expansion. The amortization of DAC increased $26 million driven by higher gross profits primarily related to the increase in fee income discussed above, and higher amortization rates driven primarily by the inclusion of unfavorable results from our living benefits hedging program in the second half of 2011 in our best estimate of total gross profits used to determine amortization rates.

2012 to 2011 Nine Month Comparison. Benefits and expenses decreased $238 million, from $2,447 million in the first nine months of 2011 to $2,209 million in the first nine months of 2012. Absent the $422 million net decrease related to the impacts of certain changes in our estimated of profitability of the business, discussed above, benefits and expenses increased $184 million. General and administrative expenses, net of capitalization, increased $130 million, driven by higher asset-based trail commissions, reflecting account value growth, as well as higher costs to support business expansion. The amortization of DAC increased $78 million driven by higher gross profits primarily related to the increase in fee income discussed above, and higher amortization rates driven primarily by the inclusion of unfavorable results from our living benefits hedging program in the second half of 2011 in our best estimate of total gross profits used to determine amortization rates.

Account Values

For our individual annuities business, since most policy fees are determined by the level of separate account assets, fee income, which is a primary driver of our revenue, varies according to the level of account values. This results in changing fee streams due to net flows from new business sales, surrenders and withdrawals, and benefit payments, as well as the impact of market changes on account values. Additionally, our fee income drives other items such as our pattern of amortization of DAC and other costs. Net sales (redemptions) are sales minus redemptions or surrenders and withdrawals, as applicable. Sales do not correspond to revenues under U.S. GAAP, but are used as a relevant measure of business activity. The following tables set forth account value information for the periods indicated.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Total Individual Annuities:				
Beginning total account value	$ 124,094	$ 116,027	$ 113,535	$ 106,185
Sales	5,926	4,487	16,243	15,871
Surrenders and withdrawals	(1,614)	(1,669)	(4,993)	(5,662)
Net sales	4,312	2,818	11,250	10,209
Benefit payments	(351)	(339)	(1,069)	(1,015)
Net flows	3,961	2,479	10,181	9,194
Change in market value, interest credited and other activity	5,342	(11,247)	10,940	(7,026)
Policy charges	(692)	(570)	(1,951)	(1,664)
Ending total account value	$ 132,705	$ 106,689	$ 132,705	$ 106,689

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	Three Months Ended				
	September 30, 2012	June 30, 2012	March 31, 2012 (in millions)	December 31, 2011	September 30, 2011
Ending variable annuity account values(1)(2)	$ 128,949	$ 120,326	$ 120,276	$ 109,743	$ 102,879
Ending fixed annuity account values	$ 3,756	$ 3,768	$ 3,778	$ 3,792	$ 3,810

(1) Variable annuities include only those sold as retail investment products. Investments sold through defined contribution plan products are included with such products within the Retirement segment.
(2) As of September 30, 2012, variable annuity account values are invested in equity portfolios ($74 billion or 57%), bond portfolios ($39 billion or 30%), market value adjusted or fixed-rate accounts ($8 billion or 7%) and money market funds ($8 billion or 6%).

As shown above, our account values are significantly impacted by net sales and the impact of market performance on customers’ accounts. The increase in gross sales for the three months ended September 30, 2012 compared to the prior year period was primarily driven by higher sales in advance of both our suspension of additional customer deposits for variable annuities with certain older optional living benefit riders, and our implementation of variable annuity product modifications for new sales to scale back benefits, increase pricing and close certain share classes in the third quarter of 2012. The increase in gross sales for the nine months ended September 30, 2012 compared to the prior year period reflects similar increases from our suspension of additional customer deposits, while the comparative impact of higher sales in advance of our implementation of variable annuity product modifications in the third quarter of 2012 was offset by similar impacts in the prior year period from product modifications we implemented in the first quarter of 2011. Additionally, we have experienced a dynamic competitive landscape, as certain of our competitors have taken actions to implement product modifications which scale back benefits and to exit, or limit their presence in, the variable annuity marketplace, and our results may continue to be impacted by these actions. The decrease in surrenders and withdrawals for the three and nine months ended September 30, 2012 compared to the prior year periods reflects the continued retention of contracts that are in-the-money and the competitiveness of our inforce product offerings relative to substitute products currently available in the marketplace.

Over the past five quarters, our account values have generally been increasing due to net flows and market appreciation, with the exception of the second quarter of 2012, which was relatively flat due to the offsetting impact of positive net flow and market declines, and the third quarter of 2011 where market depreciation was only partially offset by positive net flows. These increases have driven corresponding increases in our asset-based fee income, net of an increased level of distribution and amortization costs.

Variable Annuity Net Amount at Risk

The net amount at risk is generally defined as the present value of the guaranteed minimum benefit amount in excess of the contractholder’s current account balance, and excludes any reduction to this risk provided by our hedging program. Changes in the global financial markets can create volatility in the net amounts at risk embedded in our variable annuity products that include optional living benefit and GMDB features. As part of our risk management strategy, we hedge or limit our exposure to certain of the risks associated with these products, primarily through a combination of product design elements, such as an automatic rebalancing element, and externally purchased hedging instruments. Our hedging program is discussed below in “—Net impact of optional living benefit guarantees and related hedge positions.” The return we realize from our variable annuity contracts can vary by contract based on our risk management strategy, including the impact of any capital market movements that we may hedge, the impact of that portion of our variable annuity contracts with the automatic rebalancing element, the impact of risks we have retained and the impact of risks that are not able to be hedged.

All new sales of optional living benefit features of our variable annuity products include an automatic rebalancing element, also referred to as an asset transfer feature. Our automatic rebalancing element occurs at the contractholder level, and transfers assets between certain variable investments selected by the annuity contractholder and, depending on the benefit feature, the fixed-rate account in the general account or a bond

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portfolio within the separate accounts. The automatic rebalancing element associated with currently-sold products transfers assets between certain variable investments selected by the annuity contractholder and a designated bond portfolio within the separate accounts. The transfers are based on the static mathematical formula used with the particular benefit which considers a number of factors, including, but not limited to, the impact of investment performance on the contractholder’s total account value. In general, negative investment performance may result in transfers to either the fixed-rate account in the general account or a bond portfolio within the separate accounts, and positive investment performance may result in transfers to contractholder-selected variable investments. Overall, the automatic rebalancing element helps to mitigate our exposure to equity market risk and market volatility.

The following table sets forth the account values of our variable annuities with living benefit features and the net amount at risk of the living benefit features split between those that include an automatic rebalancing element and those that do not, as of the dates indicated.

	September 30, 2012		December 31, 2011		September 30, 2011	
	Account Value	Net Amount at Risk	Account Value	Net Amount at Risk	Account Value	Net Amount at Risk
			($ in millions)			
Automatic rebalancing element(1)	$ 88,672	$ 3,013	$ 70,341	$ 4,238	$ 64,769	$ 4,996
No automatic rebalancing element	15,529	1,701	15,300	2,361	14,753	2,934
Total variable annuity account values with living benefit features	$ 104,201	$ 4,714	$ 85,641	$ 6,599	$ 79,522	$ 7,930
			(% of total)			
Automatic rebalancing element	85%	64%	82%	64%	81%	63%
No automatic rebalancing element	15%	36%	18%	36%	19%	37%

(1) As of September 30, 2012, December 31, 2011 and September 30, 2011, asset values that have transferred to the general account or a separate account bond portfolio due to the automatic rebalancing element represent 12% or $10.9 billion of the $88.7 billion total account value, 30% or $20.9 billion of the $70.3 billion total account value and 37% or $23.7 billion of the $64.8 billion total account value, respectively.

The increase in account values that include an automatic rebalancing element as of September 30, 2012 compared to prior periods primarily reflects sales of our latest product offerings which include this feature. The decrease in the net amount at risk for these contracts as of September 30, 2012 compared to prior periods primarily reflects the impact of overall favorable equity markets in the first nine months of 2012.

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Our GMDBs provide a benefit payable in the event of death that, together with the existing contractholder’s account balance, is equal to the greater of a minimum return on the contract value or an enhanced value. The net amount at risk associated with the GMDBs provided by our variable annuity contracts shown below is the total amount of death benefit insurance, over and above the account value, that would be provided assuming the death of all insured as of the respective dates in the table. We have retained this mortality risk. A substantial portion of the account values associated with GMDBs are subject to an automatic rebalancing element because the contractholder also selected a living benefit feature which includes an automatic rebalancing element. All of the variable annuity account values with living benefit features shown in the table above also contain GMDBs. Since the living and death benefit features for these contracts cover the same insured life, the net amount at risk for living and death benefit features is not additive, as we have assumed both the mortality and longevity risk on these lives. An additional $21.7 billion, $21.1 billion and $20.5 billion of variable annuity account values, as of September 30, 2012, December 31, 2011 and September 30, 2011, respectively, contain GMDBs, but no living benefit features. The following table sets forth the account values of our variable annuities with GMDBs and the net amount at risk of these benefits split between those that are affected by an automatic rebalancing element and those that are not, as of the dates indicated.

	September 30, 2012		December 31, 2011		September 30, 2011	
	Account Value	Net Amount at Risk	Account Value	Net Amount at Risk	Account Value	Net Amount at Risk
			($ in millions)			
Automatic rebalancing element	$ 88,672	$ 983	$ 70,341	$ 2,154	$ 64,769	$ 3,042
No automatic rebalancing element	37,239	4,135	36,407	5,628	35,224	6,947
Total variable annuity account values with death benefit features	$ 125,911	$ 5,118	$ 106,748	$ 7,782	$ 99,993	$ 9,989
			(% of total)			
Automatic rebalancing element	70%	19%	66%	28%	65%	30%
No automatic rebalancing element	30%	81%	34%	72%	35%	70%

The increase in account values that include an automatic rebalancing element as of September 30, 2012 compared to prior periods primarily reflects sales of our latest product offerings which include this feature. The decrease in the net amount at risk for these contracts as of September 30, 2012 compared to prior periods primarily reflects the impact of overall favorable equity markets in the first nine months of 2012.

Net impact of optional living benefit guarantees and related hedge positions

In addition to our automatic rebalancing element, we also manage capital markets risk associated with our optional living benefit guarantee through our hedging program. This program represents a balance among three objectives: 1) provide severe scenario protection, 2) minimize net income volatility associated with an internally defined hedge target liability, and 3) maintain capital efficiency. Through our hedge program, we purchase derivatives that replicate the net change in our hedge target, discussed further below. In addition to mitigating risk and income statement volatility, the hedging program is also focused on a long-term goal of accumulating assets that could be used to pay claims under these benefits irrespective of market path, recognizing that, under the terms of the contracts, we do not expect to begin payment of such claims until some point in the future. We hedge the capital market risks on approximately $98 billion of the $104 billion of variable annuity account values with living benefit features.

Under U.S. GAAP the liability for the optional living benefit features is accounted for as an embedded derivative and recorded at fair value. The fair value is calculated as the present value of future expected benefit payments to customers less the present value of assessed rider fees attributable to the feature using option pricing techniques. See Note 13 to the Unaudited Interim Consolidated Financial Statements for additional information regarding the methodology and assumptions used in calculating the fair value under U.S. GAAP.

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As noted above, our hedge program utilizes a hedge target that is grounded in a U.S. GAAP/capital markets valuation framework, with three notable modifications.

• The impact of the market’s perception of our own non-performance risk (“NPR”) is excluded to maximize protection against the entire projected claim irrespective of the possibility of our own default.

• A credit spread is added to the risk-free rate of return assumption used under U.S. GAAP to estimate future growth of bond investments in the customer separate account funds to better replicate the projected returns within those funds.

• The equity volatility assumption is adjusted to remove certain risk margins required under U.S. GAAP valuation which are used in the projection of customer account values, as we believe the impact driven by these margins can be temporary and does not reflect the true economic value.

Due to these modifications, we expect differences each period between the change in the value of the embedded derivative as defined by U.S. GAAP and the change in the value of the hedge positions used to replicate the hedge target, thus potentially increasing volatility in U.S. GAAP earnings. As of September 30, 2012, the fair value of the embedded derivative under U.S. GAAP was a $3.6 billion liability. Excluding the impact of the cumulative adjustment for NPR of $5.7 billion, the value of the embedded derivative was a $9.3 billion liability. As of September 30, 2012, the value of our hedge target was a $7.2 billion liability.

We enter into a range of exchange-traded and over the counter equity and interest rate derivatives. The instruments include, but are not limited to: interest rate swaps, swaptions, floors and caps as well as equity options, total return swaps and equity futures to hedge certain capital market risks present in our hedge target. As of September 30, 2012, the fair value of hedge positions was a $5.5 billion asset. As noted above the hedge program is designed to replicate the changes in our hedge target.

Due to cash flow timing differences between our hedging instruments and the corresponding hedge target, as well as other factors, including updates to actuarial valuation assumptions, the amount of hedge assets compared to our hedge target measured as of any specific point in time may be different and is not expected to be fully offsetting. In addition to derivative assets held as part of the hedging program, we have cash, other invested assets and affiliated receivables available to cover affiliated loans, debt and the embedded derivative liability.

While we actively manage our hedge positions, changes in the fair value of these positions may not completely offset changes in the fair value of the hedge target. Additionally, updates to actuarial valuation assumptions, which typically occur annually in the third quarter, are generally not hedged and may result in differences between the assets and liabilities. The primary sources of the differences between the changes in the fair value of the hedge position and the hedge target, other than actuarial valuation assumption updates, fall into one of three categories:

• Fund Performance—In order to project future account value growth, we must make certain assumptions about how each underlying investment will perform. We map our funds to indices that are readily tradeable and have active derivative markets. The difference between the modeled investment performance and actual fund performance results in basis differences that can be either positive or negative.

• Rebalancing Costs and Volatility—There are costs associated with rebalancing hedge positions for basis differences between assets and liabilities. This also includes the impact of realized market volatility in excess of, or lower than, our long-term assumptions.

• Liability Basis—Reflects the impact of differences between the actual changes in the liability and the expected changes we have modeled and attempt to replicate with the hedge program. These differences arise due to the inherent complexities in predicting changes in the value of a long-dated, complex and path dependent benefit option.

The net impact of both the change in the fair value of the embedded derivative associated with our living benefit features and the change in the fair value of the related hedge positions are included in “Realized investment gains (losses), net, and related adjustments” and the related impact to the amortization of DAC and

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other costs is included in “Related charges,” both of which are excluded from adjusted operating income. The following table shows the net impact of changes in the embedded derivative and related hedge positions, as well as the related amortization of DAC and other costs, for the periods indicated.

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(1) (in millions)			
Hedge Program Results:				
Change in fair value of hedge positions	$ (1,386)	$ 4,881	$ (1,475)	$ 4,652
Change in value of hedge target liability, excluding unhedged portion and assumption updates(2)	1,724	(5,752)	1,910	(5,567)
Net hedging impact, excluding unhedged portion and assumption updates(2)	$ 338	$ (871)	$ 435	$ (915)
Impact of assumption updates on hedge target	(912)	(17)	(912)	(17)
Net hedging impact, excluding unhedged portion(2)	$ (574)	$ (888)	$ (477)	$ (932)
Reconciliation of Hedge Program Results to U.S. GAAP Results:				
Net hedging impact, excluding unhedged portion(2) (from above)	$ (574)	$ (888)	$ (477)	$ (932)
Change in portions of U.S. GAAP liability, before NPR, excluded from hedge target(3)	(372)	(875)	(845)	(792)
Change in the NPR adjustment(4)	(560)	4,794	169	5,010
Net impact from changes in the U.S. GAAP embedded derivative and hedge positions—reported in Individual Annuities(2)	(1,506)	3,031	(1,153)	3,286
Related charge to amortization of DAC and other costs(5)	690	(1,590)	587	(1,698)
Net impact from changes in the U.S. GAAP embedded derivative and hedge positions, after the impact of NPR, DAC and other costs—reported in Individual Annuities(2)	$ (816)	$ 1,441	$ (566)	$ 1,588

(1) Positive amount represents income; negative amount represents a loss.
(2) The unhedged portion represents the impact of temporarily hedging to an amount that differs from our hedge target based on the overall capital considerations of the Company and prevailing capital market conditions. Results exclude $139 million and $(155) million for the three and nine months ended September 30, 2012, respectively, and $(1,428) million and $(1,459) million for the three and nine months ended September 30, 2011, respectively, related to this impact. Because the decision to temporarily hedge to an amount that differs from our hedge target is based on overall capital considerations of the Company as a whole, this impact is reported in Corporate & Other operations. See “—Corporate & Other.”
(3) Represents the impact attributable to the difference between the value of the hedge target and the value of the embedded derivative as defined by U.S. GAAP, before adjusting for NPR. These differences include a credit spread that is added to the U.S. GAAP risk-free rate of return assumption, as well as certain risk margins embedded in the equity volatility assumption used to determine the fair value of the embedded derivative under U.S. GAAP.
(4) To reflect NPR, we incorporate an additional spread over LIBOR, which reflects the financial strength ratings of our insurance subsidiaries, into the discount rate used in the valuation of those individual living benefit contracts in a liability position and not to those in a contra-liability position. As of September 30, 2012, the value of the embedded derivative, before the adjustment for NPR, was a net liability of $9.3 billion. This net liability was comprised of $9.7 billion of individual living benefit contracts in a liability position, net of $0.4 billion of individual living benefit contracts in a contra-liability position.
(5) Related charge to amortization of DAC and other costs is excluded from adjusted operating income and included in operating results in “Related charges.”

2012 to 2011 Three Month Comparison. Market conditions in the third quarter of 2012 generally reflected improved capital markets performance, as well as lower levels of volatility. The $338 million net benefit related to the net hedging impact, excluding unhedged portion and assumption updates, was primarily driven by positive fund performance, partially offset by rebalancing costs and volatility. The $912 million net charge related to the impact of assumption updates on the hedge target was driven by updates to our policyholder behavior assumptions, primarily related to lapse and mortality rates, as well as policyholder utilization assumptions. The $560 million net charge from changes in the NPR adjustment was driven by the tightening of our NPR credit

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spreads, partially offset by the impact of assumption updates which increased and lengthened expected claims. We also included these items in gross profits used to calculate the amortization of DAC, which resulted in a net benefit of $690 million, including a $365 million net benefit from the current period impact of incorporating the net hedging impact in our best estimate of gross profits used to set amortization rates. The resulting change in our amortization rates will impact adjusted operating income in future periods, as the new rates are applied to actual gross profits. For additional information regarding the net hedging impacts that are included in our best estimate of gross profits used to set amortization rates, see “—Accounting Policies & Pronouncements—Application of Critical Accounting Estimates.”

Market conditions in the third quarter of 2011 generally reflected capital markets deterioration, as well as higher levels of volatility. The $871 million charge related to the net hedging impact, excluding unhedged portion and assumption updates, was driven by negative fund performance, rebalancing costs and volatility and liability basis differences. The $4,794 million net benefit due to changes in the NPR adjustment was driven by increases in the base embedded derivative liability before NPR primarily due to significant declines in risk-free interest rates, as well as the widening of our NPR credit spreads. We also included these items in gross profits used to calculate the amortization of DAC, which resulted in a net charge of $1,590 million, including an $86 million net charge from the current period impact of incorporating the cumulative net hedging impact in our best estimate of gross profits used to set amortization rates, based on our determination that these impacts were other-than-temporary.

For additional information regarding the methodologies used in determining the fair value of the embedded derivative liability associated with our living benefit features as defined by U.S. GAAP, and for calculating the impact of NPR, see Note 13 to the Unaudited Interim Consolidated Financial Statements and “—Valuation of Assets and Liabilities—Fair Value of Assets and Liabilities—Variable Annuity Optional Living Benefit Features.” For information regarding the Capital Protection Framework we use to evaluate and support the risks of our hedging program, see “—Liquidity and Capital Resources—Liquidity and Capital Resources of Subsidiaries—Domestic Insurance Subsidiaries.”

2012 to 2011 Nine Month Comparison. Market conditions in the first nine months of 2012 generally reflected improved capital markets performance, as well as lower levels of volatility. The $435 million net benefit related to the net hedging impact, excluding unhedged portion and assumption updates, was primarily driven by positive fund performance, partially offset by rebalancing costs and volatility. The $912 million net charge related to the impact of assumption updates on the hedge target was driven by updates to our policyholder behavior assumptions, primarily related to lapse and mortality rates, as well as policyholder utilization assumptions. The $169 million net benefit from changes in the NPR adjustment was driven by the higher base of embedded derivatives in a liability position driven by lower interest rates and the impact of assumption updates which increased and lengthened expected claims, partially offset by tightening of our NPR credit spreads. We also included these items in gross profits used to calculate the amortization of DAC, which resulted in a net benefit of $587 million, including a $378 million net benefit from the current period impact of incorporating the net hedging impact in our best estimate of gross profits used to set amortization rates.

Market conditions in the first nine months of 2011 generally reflected capital markets deterioration, as well as higher levels of volatility. The $915 million net charge related to the net hedging impact, excluding unhedged portion and assumption updates, was driven by negative fund performance, rebalancing costs and volatility and liability basis differences. The $5,010 million benefit due to changes in the NPR adjustment was driven by increases in the base embedded derivative liability before NPR primarily due to significant declines in risk-free interest rates, as well as the widening of our NPR credit spreads. We also included these items in gross profits used to calculate the amortization of DAC, which resulted in a net charge of $1,698 million, including an $86 million net charge from the current period impact of incorporating the cumulative net hedging impact in our best estimate of gross profits used to set amortization rates, based on our determination that these impacts were other-than-temporary.

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Retirement

Operating Results

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

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(in millions)			
Operating results:				
Revenues	$ 1,162	$ 1,171	$ 3,511	$ 3,625
Benefits and expenses	1,052	1,060	3,098	3,171
Adjusted operating income	110	111	413	454
Realized investment gains (losses), net, and related adjustments(1)	(65)	263	(66)	244
Related charges(2)	1	(3)	1	(9)
Investment gains on trading account assets supporting insurance liabilities, net(3)	268	119	436	306
Change in experience-rated contractholder liabilities due to asset value changes(4)	(258)	(41)	(380)	(212)
Income from continuing operations before income taxes and equity in earnings of operating joint ventures	$ 56	$ 449	$ 404	$ 783

(1) Revenues exclude Realized investment gains (losses), net, and related adjustments. See “—Realized Investment Gains and Losses” and “—Experience-Rated Contractholder Liabilities, Trading Account Assets Supporting Insurance Liabilities and Other Related Investments.”
(2) Benefits and expenses exclude charges which represent the unfavorable (favorable) impact of Realized investment gains (losses), net, on changes in reserves and the amortization of deferred policy acquisition costs.
(3) Revenues exclude net investment gains and losses on trading account assets supporting insurance liabilities. See “—Experience-Rated Contractholder Liabilities, Trading Account Assets Supporting Insurance Liabilities and Other Related Investments.”
(4) Benefits and expenses exclude changes in contractholder liabilities due to asset value changes in the pool of investments supporting experience-rated contracts. See “—Experience-Rated Contractholder Liabilities, Trading Account Assets Supporting Insurance Liabilities and Other Related Investments.”

Divestiture of Prudential Bank & Trust, FSB Bank Deposits

During the second quarter of 2012, Prudential Bank & Trust, FSB (“PB&T”) divested bank deposits in connection with the previously announced decision to limit its operations to trust services. The divestiture resulted in $9 million of losses from the sale and related transaction costs in the second quarter of 2012. Additionally, our results for the three and nine months ended September 30, 2012 reflect the loss of positive net investment spread earnings from the PB&T deposits, which will continue in future periods.

Adjusted Operating Income

2012 to 2011 Three Month Comparison. Adjusted operating income decreased $1 million, from $111 million in the third quarter of 2011 to $110 million in the third quarter of 2012. The decrease includes a $29 million charge in the third quarter of 2012 to write off an intangible asset, due to the impact of the prolonged economic downturn on the expected results of a business we acquired in 2008. The decrease also includes the impact of certain changes in our estimated profitability of the business on the amortization of DAC and value of business acquired (“VOBA”). These changes resulted in net charges of $17 million and $22 million for the third quarter of 2012 and 2011, respectively, related to our annual review and update of economic and actuarial assumptions, and a net benefit of $4 million and net charge of $2 million, respectively, related to quarterly adjustments for current period experience. Collectively, the net charge of $13 million in the third quarter of 2012 was primarily driven by a reduction to long-term interest and equity rate of return assumptions, while the net charge of $24 million in the third quarter of 2011 was driven by changes to expense and net cash flow assumptions.

Excluding these items, adjusted operating income increased $17 million, primarily reflecting higher net investment spread results and higher asset-based fee income, partially offset by an unfavorable comparative reserve impact from case experience. Higher net investment spread results reflect the impacts of lower crediting rates driven by rate resets in the third quarter of 2012 and higher general account stable value account values in our full service business, as well as higher income from alternative investments and mark-to-market gains on our equity investments in certain separate accounts in our institutional investment products business. These increases were partially offset by the impacts of lower reinvestment rates and lower bank deposits, as discussed above. Higher asset-based fee income primarily reflects an increase in investment-only stable value account values in our institutional investment products business driven by net additions, partially offset by lower average full service fee-based retirement account values driven by net outflows. The unfavorable comparative reserve impact from case experience was primarily driven by higher mortality losses in the third quarter of 2012.

2012 to 2011 Nine Month Comparison. Adjusted operating income decreased $41 million, from $454 million in the first nine months of 2011 to $413 million in the first nine months of 2012. The decrease includes a $29 million charge in the third quarter of 2012 to write off an intangible asset, due to the impact of the prolonged economic downturn on the expected results of a business we acquired in 2008. The decrease also includes the impact of certain changes in our estimated profitability of the business on the amortization of DAC and VOBA. These changes resulted in net charges of $17 million and $22 million for the first nine months of 2012 and 2011, respectively, related to our annual review and update of economic and actuarial assumptions performed in the third quarter, and net charges of $2 million and $3 million, respectively, related to quarterly adjustments for current period experience. Collectively, the net charge of $19 million in the first nine months of 2012 was primarily driven by a reduction to long-term interest and equity rate of return assumptions, while the net charge of $25 million in the first nine months of 2011 was driven by changes to expense and net cash flow assumptions. The decrease in adjusted operating income for the first nine months of 2012 also includes a $9 million charge in the second quarter of 2012 from costs related to the divestiture of bank deposits held by PB&T, as discussed above.

Excluding these items, adjusted operating income decreased $9 million, primarily reflecting lower net investment spread results and an unfavorable comparative reserve impact from case experience, partially offset by higher asset-based fee income and lower general and administrative expenses, net of capitalization. Lower net investment spread results reflect the impacts of lower reinvestment rates and lower bank deposits, as discussed above, partially offset by the impacts of lower crediting rates driven by rate resets in the first and third quarters of 2012 and higher general account stable value account values in our full service business, as well as higher income from alternative investments in our institutional investment products business. The unfavorable comparative reserve impact from case experience was primarily driven by mortality losses in the first nine months of 2012 compared with mortality gains in the first nine months of 2011. Higher asset-based fee income primarily reflects an increase in investment-only stable value account values in our institutional investment products business driven by net additions, partially offset by lower average full service fee-based retirement account values driven by net outflows. Lower general and administrative expenses, net of capitalization, primarily reflects costs incurred in the first quarter of 2011 related to certain legal matters.

Revenues

2012 to 2011 Three Month Comparison. Revenues, as shown in the table above under “—Operating Results,” decreased $9 million, from $1,171 million in the third quarter of 2011 to $1,162 million in the third quarter of 2012. Premiums decreased $25 million, driven by lower sales of life-contingent structured settlements and single premium annuities, partially offset by higher premiums assumed on longevity reinsurance contracts. The overall decrease in premiums resulted in a corresponding decrease in policyholders’ benefits, including the change in policy reserves, as discussed below. Net investment income decreased $19 million primarily reflecting lower portfolio yields and the impact of lower bank deposits, partially offset by the impact of higher general account stable value account values in our full service business and mark-to-market gains on our equity investments in certain separate accounts. Policy charges and fee income, and asset management fees and other

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income, increased $35 million, primarily from higher asset-based fees reflecting the impacts of an increase in investment-only stable value account values in our institutional investment products business driven by net additions, partially offset by lower average full service fee-based retirement account values driven by net outflows. Also contributing to the increase in other income was higher income from alternative investments.

2012 to 2011 Nine Month Comparison. Revenues decreased $114 million, from $3,625 million in the first nine months of 2011 to $3,511 million in the first nine months of 2012. Premiums decreased $100 million, driven by lower sales of life-contingent structured settlements and non-participating group annuity separate accounts, partially offset by higher premiums assumed on longevity reinsurance contracts and higher sales of single premium annuities. The overall decrease in premiums resulted in a corresponding decrease in policyholders’ benefits, including the change in policy reserves, as discussed below. Net investment income decreased $73 million primarily reflecting lower portfolio yields and the impact of lower bank deposits, partially offset by the impact of higher general account stable value account values in our full service business. Policy charges and fee income, and asset management fees and other income, increased $59 million, primarily from higher asset-based fees reflecting the impacts of an increase in investment-only stable value account values in our institutional investment products business driven by net additions, partially offset by lower average full service fee-based retirement account values driven by net outflows. Also contributing to the increase in other income was higher income from alternative investments.

Benefits and Expenses

2012 to 2011 Three Month Comparison. Benefits and expenses, as shown in the table above under “—Operating Results,” decreased $8 million, from $1,060 million in the third quarter of 2011 to $1,052 million in the third quarter of 2012. Absent the $18 million net increase in expenses from the intangible asset write off and certain changes in our estimated profitability of the business on the amortization of DAC and VOBA, discussed above, benefits and expenses decreased $26 million. Policyholders’ benefits, including the change in policy reserves, decreased $16 million, primarily reflecting a decrease in change in policy reserves associated with the decrease in premiums as discussed above, partially offset by an unfavorable comparative reserve impact from case experience. Interest credited to policyholders’ account balances decreased $9 million, driven by the impacts of lower crediting rates from rate resets and lower bank deposits, partially offset by the impact of higher general account stable value account values in our full service business.

2012 to 2011 Nine Month Comparison. Benefits and expenses decreased $73 million, from $3,171 million in the first nine months of 2011 to $3,098 million in the first nine months of 2012. Absent the $32 million net increase in expenses from the intangible asset write off, certain changes in our estimated profitability of the business on the amortization of DAC and VOBA and the costs related to the divestiture of bank deposits, discussed above, benefits and expenses decreased $105 million. Policyholders’ benefits, including the change in policy reserves, decreased $73 million, primarily reflecting a decrease in change in policy reserves associated with the decrease in premiums as discussed above, partially offset by an unfavorable comparative reserve impact from case experience. The amortization of DAC decreased $20 million primarily driven by a refinement in the first quarter of 2011 to the methodology applied in calculating amortization for certain structured settlement contracts, with an equally offsetting impact to interest credited to policyholders’ account balances. General and administrative expenses, net of capitalization, decreased $19 million, primarily driven by costs incurred in the first quarter of 2011 related to certain legal matters and a decline in life-contingent structured settlement commissions. Interest credited to policyholders’ account balances increased $3 million primarily driven by a refinement in the first quarter of 2011 to the methodology applied in calculating reserves for certain structured settlement contracts, as mentioned above. The increase also reflects the impact of higher general account stable value account values in our full service business, partially offset by the impacts of lower crediting rates driven by rate resets and lower bank deposits.

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Sales Results and Account Values

Our sales results and account values are significant drivers of our operating results. For our fee-based products, the income we earn varies with the level of fee-based account values, since many policy fees are determined by these values. For our spread-based products, both the investment income and interest we credit to policyholders vary with the level of general account values. To a lesser extent, these impacts drive other items such as our pattern of amortization of DAC and VOBA, and general and administrative expenses.

The following table shows the changes in the account values and net additions (withdrawals) of Retirement segment products for the periods indicated. Net additions (withdrawals) are deposits and sales or additions, as applicable, minus withdrawals and benefits. These concepts do not correspond to revenues under U.S. GAAP, but are used as a relevant measure of business activity. Account values include both internally- and externally-managed client balances as the total balances drive revenue for the Retirement segment. For more information on internally-managed balances see “—Asset Management.”

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Full Service(1):				
Beginning total account value	$ 142,405	$ 146,580	$ 139,430	$ 141,313
Deposits and sales	3,478	3,966	12,487	12,942
Withdrawals and benefits	(4,063)	(4,126)	(14,837)	(13,267)
Change in market value, interest credited and interest income and other activity(2)	5,114	(12,222)	9,854	(6,790)
Ending total account value	$ 146,934	$ 134,198	$ 146,934	$ 134,198
Net additions (withdrawals)	$ (585)	$ (160)	$ (2,350)	$ (325)
Institutional Investment Products(3):				
Beginning total account value	$ 102,443	$ 74,131	$ 90,089	$ 64,183
Additions	2,957	5,571	15,813	16,948
Withdrawals and benefits(4)	(1,539)	(1,501)	(5,909)	(4,066)
Change in market value, interest credited and interest income	1,509	2,176	3,999	3,848
Other(5)	(724)	136	654	(400)
Ending total account value(6)	$ 104,646	$ 80,513	$ 104,646	$ 80,513
Net additions(6)	$ 1,418	$ 4,070	$ 9,904	$ 12,882

(1) Ending total account value for the full service business includes assets of Prudential’s retirement plans of $6.5 billion and $5.6 billion as of September 30, 2012 and 2011, respectively.

(2) Change in market value, interest credited and interest income and other activity includes $(1.4) billion for the nine months ended September 30, 2012 representing the divestiture of bank deposits held by PB&T, as a result of our decision to limit its operations to trust services.

(3) Ending total account value for the institutional investment products business includes assets of Prudential’s defined benefit plan of $6.1 billion and $5.8 billion as of September 30, 2012 and 2011, respectively. Ending total account value for the institutional investment products business also includes $1.5 billion as of both September 30, 2012 and 2011 related to collateralized funding agreements issued to the Federal Home Loan Bank of New York (FHLBNY), and $0.5 billion and $0.6 billion as of September 30, 2012 and 2011, respectively, related to affiliated funding agreements issued using the proceeds from the sale of Prudential Financial retail medium-term notes. For additional information regarding the FHLBNY and the retail medium-term notes program see, “—Liquidity and Capital Resources.”

(4)

Withdrawals and benefits includes $(9) million and $(902) million for the three and nine months ended September 30, 2012, respectively, and $(16) million and $(68) million for the three and nine months ended September 30, 2011, respectively, representing transfers of client balances from accounts we manage to externally-managed accounts. These withdrawals are offset within Other, as there is no net impact on ending account values for these transfers.

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(5) Other includes transfers from (to) the Asset Management segment of $131 million for the three months ended September 30, 2012, and $(415) million for the nine months ended September 30, 2011. Other also includes $9 million and $902 million for the three and nine months ended September 30, 2012, respectively, and $16 million and $68 million for the three and nine months ended September 30, 2011, respectively, representing transfers of client balances from accounts we manage to externally-managed accounts. These transfers are offset within Withdrawals and benefits, as there is no net impact on ending account values for these transfers. Remaining amounts for all periods presented primarily represent changes in asset balances for externally-managed accounts.

(6) Ending total account value for the institutional investment products business includes investment-only stable value account values of $55.9 billion and $33.4 billion as of September 30, 2012 and 2011, respectively. Net additions for the institutional investment products business include investment-only stable value account value net additions of $2.0 billion and $12.9 billion for the three and nine months ended September 30, 2012, respectively, and $4.7 billion and $14.5 billion for the three and nine months ended September 30, 2011, respectively.

Account values in our full service business are significantly impacted by net flows and the impact of market performance on the value of customer funds. Accordingly, the increases in account values compared to the prior periods shown above primarily reflect equity market appreciation in 2012, partially offset by net withdrawals. Additionally, the change in account values compared to the 2011 periods also reflect the divestiture of bank deposits in the second quarter of 2012, as discussed above. The increase in net withdrawals for the three months ended September 30, 2012 compared to the prior year period was primarily due to lower plan sales, driven by lower sales volume and a decrease in the average size of new plans. The increase in net withdrawals for the nine months ended September 30, 2012 compared to the prior year period reflects similar impacts, as well as a higher volume of large plan lapses.

Account values in our institutional investment products business are also significantly impacted by net flows and the impact of market performance on the value of customer funds. Accordingly, the increases in account values compared to the prior periods shown above primarily reflect net additions and increases in the market value of customer funds driven by declines in fixed income yields. The decrease in net additions for the three months ended September 30, 2012 compared to the prior year period was primarily due to a decrease in overall sales volume, as well as in the average size of new fee-based investment-only stable value plans. The decrease in net additions for the nine months ended September 30, 2012 compared to the prior year period reflects similar impacts, as well as a transfer of client balances from accounts we manage to externally-managed accounts. Despite the declines in net additions of fee-based investment-only stable value plans, we believe this product remains competitively positioned.

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Asset Management

Operating Results

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

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(in millions)			
Operating results:				
Revenues	$ 634	$ 513	$ 1,656	$ 1,717
Expenses	447	390	1,300	1,213
Adjusted operating income	187	123	356	504
Realized investment gains (losses), net, and related adjustments(1)	(13)	16	(18)	1
Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests(2)	23	10	52	64
Income from continuing operations before income taxes and equity in earnings of operating joint ventures	$ 197	$ 149	$ 390	$ 569

(1) Revenues exclude Realized investment gains (losses), net, and related adjustments. See “—Realized Investment Gains and Losses.”

(2) Equity in earnings of operating joint ventures are included in adjusted operating income but excluded from income from continuing operations before income taxes and equity in earnings of operating joint ventures as they are reflected on a U.S. GAAP basis on an after-tax basis as a separate line in our Unaudited Interim Consolidated Statements of Operations. Earnings attributable to noncontrolling interests are excluded from adjusted operating income but included in income from continuing operations before income taxes and equity in earnings of operating joint ventures as they are reflected on a U.S. GAAP basis as a separate line in our Unaudited Interim Consolidated Statements of Operations. Earnings attributable to noncontrolling interests represent the portion of earnings from consolidated entities that relate to the equity interests of minority investors.

Adjusted Operating Income

2012 to 2011 Three Month Comparison. Adjusted operating income increased $64 million, from $123 million in the third quarter of 2011 to $187 million in the third quarter of 2012 primarily reflecting a greater contribution from the segment’s incentive, transaction, strategic investing and commercial mortgage activities. Strategic investing results increased $32 million primarily driven by appreciation in real estate co-investment values as well as improved performance in fixed income investments. Additionally, results increased $22 million from performance-based incentive fees, net of direct expenses, reflecting higher fees in our public fixed income business primarily resulting from market value increases. Results for the third quarter of 2012 also reflect an increase in asset management fees, before associated expenses, primarily from institutional and retail customer assets as a result of higher asset values due to market appreciation and positive net asset flows since the third quarter of 2011.

These increases were partially offset by an increase in compensation costs, due to higher earnings subject to compensation and increased headcount, as well as increases in other costs supporting the business.

2012 to 2011 Nine Month Comparison. Adjusted operating income decreased $148 million, from $504 million in the first nine months of 2011 to $356 million in the first nine months of 2012 reflecting lower contributions from the segment’s strategic investing activities. The decrease in strategic investing activities reflects $101 million of declines in values on certain real estate-related investments in the first nine months of 2012, including a $75 million impairment on a single investment, of which $61 million relates to prior periods. This compares to a $75 million contribution from real estate strategic investing activities in the first nine months of 2011 primarily driven by a $61 million gain on a partial sale of a real estate seed investment. Additionally, results for the first nine months of 2012 reflect an increase in operating expenses, largely related to increased compensation reflecting higher earnings subject to compensation and increased headcount, as well as increased expenses related to business growth and new fund launches.

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These decreases were partially offset by an increase in asset management fees, before associated expenses, primarily from institutional and retail customer assets as a result of higher asset values due to market appreciation and positive net asset flows since the third quarter of 2011.

Revenues

The following tables set forth the Asset Management segment’s revenues, presented on a basis consistent with the table above under “—Operating Results,” by type.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Revenues by type:				
Asset management fees by source:				
Institutional customers	$ 191	$ 178	$ 564	$ 530
Retail customers(1)	126	107	359	319
General account	89	82	258	242
Total asset management fees	406	367	1,181	1,091
Incentive fees	25	(5)	25	8
Transaction fees	8	6	29	27
Strategic investing	32	0	(47)	100
Commercial mortgage(2)	48	34	110	106
Other related revenues	113	35	117	241
Service, distribution and other revenues(3)	115	111	358	385
Total revenues	$ 634	$ 513	$ 1,656	$ 1,717

(1) Consists of fees from: (a) individual mutual funds and both variable annuities and variable life insurance asset management revenues from our separate accounts; (b) funds invested in proprietary mutual funds through our defined contribution plan products; and (c) third party sub-advisory relationships. Revenues from fixed annuities and the fixed-rate accounts of both variable annuities and variable life insurance are included in the general account.

(2) Includes mortgage origination and spread lending revenues of our commercial mortgage origination and servicing business.

(3) Includes payments from Wells Fargo under an agreement dated as of July 30, 2004 implementing arrangements with respect to money market mutual funds in connection with the combination of our retail securities brokerage and clearing operations with those of Wells Fargo. The agreement extends for ten years after termination of the Wachovia Securities joint venture, which occurred on December 31, 2009. The revenue from Wells Fargo under this agreement was $17 million and $19 million in the three months ended September 30, 2012 and 2011, respectively, and $49 million and $55 million in the nine months ended September 30, 2012 and 2011, respectively.

2012 to 2011 Three Month Comparison. Revenues, as shown in the table above under “—Operating Results,” increased $121 million, from $513 million in the third quarter of 2011 to $634 million in the third quarter of 2012. Asset management fees increased $39 million primarily from the management of institutional and retail customer assets as a result of higher asset values due to market appreciation and positive net asset flows since the third quarter of 2011. Strategic investing revenues increased $32 million driven by appreciation in real estate co-investments values and improved performance in fixed income investments. Performance-based incentive fees increased $30 million reflecting higher fees in our public and private fixed income businesses primarily resulting from market value increases. Commercial mortgage revenues increased $14 million reflecting higher agency fees due to higher production.

2012 to 2011 Nine Month Comparison. Revenues decreased $61 million, from $1,717 million in the first nine months of 2011 to $1,656 million in the first nine months of 2012. Strategic investing revenues decreased $147 million reflecting $95 million of declines in values on certain real estate-related investments in the first nine months of 2012, including a $75 million impairment on a single investment, as discussed above. This compares

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to an $86 million contribution from real estate strategic investing activities in the first nine months of 2011, primarily driven by a $61 million gain in the second quarter of 2011 on a partial sale of a real estate seed investment, as discussed above. Service, distribution and other revenues decreased $27 million, which includes lower revenues for certain consolidated funds, which were fully offset by lower expenses related to the noncontrolling interest in these funds, as well as lower revenues from our wealth management platform.

Partially offsetting the decreases in revenue above was an increase in asset management fees of $90 million primarily from the management of institutional and retail customer assets as a result of higher asset values due to market appreciation and positive net asset flows since the third quarter of 2011. Additionally, performance-based incentive fees increased $17 million reflecting higher fees in our public fixed income business primarily resulting from market value increases. A portion of incentive-based fees are offset in incentive compensation expense in accordance with the terms of contractual agreements. Certain of our incentive fees continue to be subject to positive or negative future adjustment based on cumulative fund performance in relation to specified benchmarks. As of September 30, 2012, $87 million in cumulative incentive fee revenue, net of compensation, is subject to future adjustment. Future incentive, transaction, strategic investing and commercial mortgage revenues will be impacted by the level and diversification of our strategic investments, the commercial real estate market, and other domestic and international market conditions.

Expenses

2012 to 2011 Three Month Comparison. Expenses, as shown in the table above under “—Operating Results,” increased $57 million, from $390 million in the third quarter of 2011 to $447 million in the third quarter of 2012, driven primarily by an increase in compensation costs, due to higher earnings subject to compensation and increased headcount, as well as increases in other costs supporting the business. In addition, expenses related to revenues associated with certain consolidated funds increased.

2012 to 2011 Nine Month Comparison. Expenses increased $87 million, from $1,213 million in the first nine months of 2011 to $1,300 million in the first nine months of 2012, primarily driven by an increase in compensation costs, due to higher earnings subject to compensation and increased headcount, as well as increased costs related to business growth and new fund launches. These increases were partially offset by lower expenses related to revenues associated with certain consolidated funds, as discussed above.

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Assets Under Management

The following tables set forth assets under management by asset class and source as of the dates indicated and net additions, excluding money market activity, by source for the periods indicated. In managing our business, we analyze assets under management, which do not correspond to U.S. GAAP assets, because the principal source of revenues is fees based on assets under management.

	September 30, 2012	December 31, 2011 (in billions)	September 30, 2011
Assets Under Management (at fair market value):			
Institutional customers:			
Equity	$ 49.1	$ 44.2	$ 42.2
Fixed income	220.5	197.2	189.6
Real estate	30.6	27.7	27.0
Institutional customers(1)(2)	300.2	269.1	258.8
Retail customers:			
Equity	85.3	70.8	63.7
Fixed income	45.6	45.7	45.0
Real estate	1.4	1.4	1.4
Retail customers(3)	132.3	117.9	110.1
General account:			
Equity	4.6	4.2	3.8
Fixed income	231.7	226.6	225.4
Real estate	1.4	1.3	1.3
General account	237.7	232.1	230.5
Total assets under management	$ 670.2	$ 619.1	$ 599.4

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in billions)			
Net additions (withdrawals), excluding money market activity:				
Third Party:				
Institutional customers(4)	$ 3.4	$ 2.1	$ 8.8	$ 13.0
Retail customers	1.7	0.5	8.7	2.3
Affiliated:				
Institutional customers	0.3	(0.3)	(1.2)	(2.0)
Retail customers	(5.5)	14.0	(7.6)	14.4
General account(5)	(0.7)	1.8	(2.0)	14.7
Total net additions (withdrawals), excluding money market activity	$ (0.8)	$ 18.1	$ 6.7	$ 42.4

(1) Consists of third-party institutional assets and group insurance contracts.
(2) As of September 30, 2012, December 31, 2011 and September 30, 2011, includes $34.8 billion, $29.7 billion and $26.1 billion, respectively, of assets under management related to investment-only stable value products.
(3) Consists of: (a) individual mutual funds and both variable annuities and variable life insurance assets in our separate accounts; (b) funds invested in proprietary mutual funds through our defined contribution plan products; and (c) third-party sub-advisory relationships. Fixed annuities and the fixed-rate accounts of both variable annuities and variable life insurance are included in the general account.
(4) Three months ended September 30, 2012 and 2011, includes $0.6 billion and $1.9 billion, respectively, and the nine months ended September 30, 2012 and 2011, includes $4.1 billion and $7.2 billion, respectively, of net additions related to investment-only stable value products.
(5) The nine months ended September 30, 2011 includes $15.2 billion in net additions from the acquisition of the Star and Edison Businesses.

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Assets under management increased $51.1 billion from December 31, 2011 to September 30, 2012. Institutional assets under management increased $31.1 billion from December 31, 2011 to September 30, 2012 driven by market appreciation of $23.2 billion, as well as net additions of $8.8 billion from third-party clients from positive flows into fixed income accounts, including $4.1 billion of net additions associated with investment-only stable value products. Retail assets under management increased $14.4 billion from December 31, 2011 to September 30, 2012 driven by market appreciation of $12.9 billion, net additions of $8.7 billion from third-party clients from positive flows into both fixed income and equity accounts, partially offset by net affiliated withdrawals of $7.6 billion primarily from assets being transferred out of a fixed income fund due to the automatic rebalancing feature within certain variable annuity products. General account assets increased $5.6 billion due largely to market appreciation of $10.1 billion partially offset by net withdrawals primarily from fixed income funds.

Assets under management increased $70.8 billion from September 30, 2011 to September 30, 2012. Institutional assets under management increased $41.4 billion from September 30, 2011 to September 30, 2012 driven by market appreciation of $30.3 billion, as well as net additions of $12.5 billion from third-party clients, primarily from positive flows into fixed income accounts, including $6.9 billion of net additions associated with investment-only stable value products. Retail assets under management increased $22.2 billion from September 30, 2011 to September 30, 2012 from market appreciation of $19.7 billion, net additions of $9.9 billion from third-party clients primarily from positive flows into fixed income and equity accounts offset by net affiliated withdrawals of $7.5 billion primarily from assets being transferred out of a fixed income fund due to the automatic rebalancing feature within certain variable annuity products. General account assets increased $7.2 billion driven by market appreciation of $13.1 billion offset by net withdrawals primarily from fixed income funds.

Strategic Investments

The following table sets forth the strategic investments of the Asset Management segment at carrying value (including the value of derivative instruments used to mitigate equity market and currency risk) by asset class and source as of the dates indicated.

	September 30,	
	2012	2011
	(in millions)	
Co-Investments:		
Real estate	$ 462	$ 461
Fixed income	25	25
Seed Investments:		
Real estate	31	20
Public equity	208	166
Fixed income	204	195
Loans Secured by Investor Equity Commitments or Fund Assets:		
Real estate secured by investor equity	0	42
Real estate secured by fund assets	0	95
Total	$ 930	$ 1,004

In addition to the strategic investments above, the Asset Management segment’s commercial mortgage operations maintains an interim loan portfolio. See “—General Account Investments—Invested Assets of Other Entities and Operations—Fixed Maturity Securities-Invested Assets of Other Entities and Operations—Commercial Mortgage and Other Loans” below for additional details.

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U.S. Individual Life and Group Insurance Division

Individual Life

Operating Results

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

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(in millions)			
Operating results:				
Revenues	$ 948	$ 643	$ 2,527	$ 2,131
Benefits and expenses	836	532	2,242	1,787
Adjusted operating income	112	111	285	344
Realized investment gains (losses), net, and related adjustments(1)	13	(44)	36	(46)
Income from continuing operations before income taxes and equity in earnings of operating joint ventures	$ 125	$ 67	$ 321	$ 298

(1) Revenues exclude Realized investment gains (losses), net, and related adjustments. See “—Realized Investment Gains and Losses.”

Adjusted Operating Income

2012 to 2011 Three Month Comparison. Adjusted operating income for the third quarter of 2012 was relatively unchanged from the third quarter of 2011. Adjusted operating income includes $27 million of net charges and $27 million of net benefits in the third quarter of 2012 and 2011, respectively, reflecting the impact of certain changes in our estimated profitability of the business resulting from our annual review and update of economic and actuarial assumptions. This annual review covers assumptions used in our estimate of total gross profits which forms the basis for amortizing DAC and unearned revenue reserves (“URR”), as well as establishing the reserve for the GMDB feature in certain contracts. The $27 million net charge in the third quarter of 2012 primarily reflects reductions to our long-term interest rate and equity return assumptions, which resulted in adjustments increasing both the amortization of DAC and URR and increasing the reserves for the GMDB features in certain contracts. The $27 million net benefit in the third quarter of 2011 primarily reflects more favorable lapse and mortality experience.

Absent the effect of these items, adjusted operating income for the third quarter of 2012 increased $55 million from the third quarter of 2011 driven by improved mortality experience, net of reinsurance, of $38 million, which was favorable relative to expected levels in the current period and was unfavorable relative to expected levels in the third quarter of 2011. The increase in adjusted operating income also reflects a $17 million benefit resulting from changes in our estimates of total gross profits arising from separate account fund performance that impacted the amortization of DAC and other costs. This benefit largely reflects the impact of equity markets on separate account fund performance in the respective periods. Higher than expected market returns in the third quarter of 2012 resulted in a net benefit of $2 million compared to lower than expected market returns in the third quarter of 2011 which resulted in a $15 million net expense.

For weighted average rate of return assumptions as of September 30, 2012 see “—Accounting Policies & Pronouncements—Application of Critical Accounting Estimates.” For additional information on our policy for amortizing DAC and URR, and for estimating future expected claims costs associated with the GMDB feature of our variable insurance products, see our Annual Report on Form 10-K for the year ended December 31, 2011, under “—Management’s Discussion and Analysis of Financial Condition and Results of Operations—Accounting Policies & Pronouncements—Application of Critical Accounting Estimates.”

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2012 to 2011 Nine Month Comparison. Adjusted operating income decreased $59 million, from $344 million in the first nine months of 2011 to $285 million in the first nine months of 2012. Adjusted operating income includes $27 million of net charges and $27 million of net benefits in the first nine months of 2012 and 2011, respectively, reflecting the impact of certain changes in our estimated profitability of the business related to our annual review and update of economic and actuarial assumptions, as discussed above. Absent the effect of these items, adjusted operating income for the first nine months of 2012 decreased $5 million from the first nine months of 2011 driven by mortality experience, net of reinsurance, of $16 million, which was more unfavorable relative to expected levels in the current period, compared to the first nine months of 2011. The decrease in adjusted operating income also reflects an $11 million charge in the first quarter of 2012 related to the correction of a delay in the execution of certain client mutual fund transactions. These unfavorable items were partially offset by a $20 million benefit resulting from changes in our estimates of total gross profits arising from separate account fund performance that impacted the amortization of DAC and other costs. This largely reflects the impact of equity markets on separate account fund performance in the respective periods. Higher than expected market returns in the first nine months of 2012 resulted in a net benefit of $6 million compared to lower than expected market returns in the first nine months of 2011 which resulted in a $14 million net expense.

Revenues

2012 to 2011 Three Month Comparison. Revenues, as shown in the table above under “—Operating Results,” increased $305 million, from $643 million in the third quarter of 2011 to $948 million in the third quarter of 2012. Policy charges and fees and asset management fees and other income increased $290 million including a $246 million increase in amortization of URR reflecting the impact of our annual reviews and update of economic and actuarial assumptions. Absent this item, policy charges and fees and asset management fees and other income increased $44 million, primarily driven by $24 million of income on an affiliated note received as part of a financing transaction for certain regulatory capital requirements, which is offset by higher interest expense as described below. Also included in policy charges and fees and asset management fees and other income was an increase driven by growth in our universal life insurance business and higher income from alternative investments, partially offset by the ongoing impact of run-off of variable life insurance in force. Partially offsetting these favorable items was a $26 million decrease in amortization of URR due to changes in our estimates of total gross profits primarily reflecting the impact of favorable market conditions on separate account fund performance in the third quarter of 2012 compared to unfavorable market conditions in the prior year period. Net investment income increased $13 million reflecting business growth, partially offset by the impact of lower portfolio reinvestment rates.

2012 to 2011 Nine Month Comparison. Revenues increased $396 million, from $2,131 million in the first nine months of 2011 to $2,527 million in the first nine months of 2012. Policy charges and fees and asset management fees and other income increased $349 million including a $246 million increase in amortization of URR reflecting the impact of our annual reviews and update of economic and actuarial assumptions. Absent this item, policy charges and fees and asset management fees and other income increased $103 million, primarily driven by $72 million of income on an affiliated note received as part of a financing transaction for certain regulatory capital requirements, which is offset by higher interest expense as described below. The increase in policy charges and fees and asset management fees and other income also reflects growth in our universal life insurance business and higher income from alternative investments, partially offset by the ongoing impact of run-off of variable life insurance in force. These favorable items were partially offset by the impact of a $31 million decrease in amortization of URR due to changes in our estimates of total gross profits primarily reflecting the impact of favorable market conditions on separate account fund performance in the current year period compared to unfavorable market conditions in the prior year period. Net investment income increased $42 million reflecting business growth, partially offset by the impact of lower portfolio reinvestment rates.

Benefits and Expenses

2012 to 2011 Three Month Comparison. Benefits and expenses, as shown in the table above under “—Operating Results,” increased $304 million, from $532 million in the third quarter of 2011 to $836 million in the third quarter of 2012. Absent the impact of annual reviews conducted in the third quarter of both periods,

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benefits and expenses increased $4 million, from $684 million in the third quarter of 2011 to $688 million in the third quarter of 2012. The increase in benefits and expenses includes higher interest expense of $32 million reflecting higher costs associated with the financing of regulatory capital requirements, of which, $24 million related to a financing transaction associated with certain universal life insurance policies is offset in revenues. The increase in benefits and expenses was partially offset by a $20 million decrease in DAC amortization driven by changes in estimated total gross profits primarily reflecting the impact of favorable market conditions on separate account fund performance in the current year period compared to unfavorable market conditions in the prior year period. In addition, insurance and annuity benefits, including interest credited to policyholders’ account balances, decreased $13 million primarily driven by improved mortality experience, net of reinsurance, of $38 million, relative to expected levels, partially offset by an increase in interest credited to policyholders from higher universal life account balances from policyholder deposits and an increase in policyholder reserves driven by growth in our term and universal life blocks of business.

2012 to 2011 Nine Month Comparison. Benefits and expenses increased $455 million, from $1,787 million in the first nine months of 2011 to $2,242 million in the first nine months of 2012. Absent the impact of annual reviews conducted in the third quarter of both periods, benefits and expenses increased $155 million, from $1,939 million in the first nine months of 2011 to $2,094 million in the first nine months of 2012. The increase in benefits and expenses includes higher interest expense of $94 million reflecting higher costs associated with the financing of regulatory capital requirements, of which, $72 million related to a financing transaction associated with certain universal life insurance policies is offset in revenues. Insurance and annuity benefits, including interest credited to policyholders’ account balances, increased $79 million primarily driven by $44 million higher policyholder benefits including more unfavorable mortality experience, net of reinsurance, of $16 million, relative to expected levels, an increase in interest credited to policyholders from higher universal life account balances from policyholder deposits and an increase in policyholder reserves driven by growth in our term and universal life blocks of business. These unfavorable items were partially offset by a $32 million decrease in DAC amortization primarily reflecting the impact of favorable market conditions on separate account fund performance in the current year period compared to unfavorable market conditions in the prior year period.

Sales Results

The following table sets forth individual life insurance annualized new business premiums for the periods indicated. In managing our individual life insurance business, we analyze annualized new business premiums, which do not correspond to revenues under U.S. GAAP, because annualized new business premiums measure the current sales performance of the business, while revenues primarily reflect the renewal persistency and aging of in force policies written in prior years and net investment income, in addition to current sales. Annualized new business premiums include 10% of first year excess premiums and deposits.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Annualized New Business Premiums(1):				
Variable Life	$ 4	$ 8	$ 13	$ 21
Universal Life	52	21	128	66
Term Life	42	41	127	116
Total	$ 98	$ 70	$ 268	$ 203
Annualized New Business Premiums by Distribution Channel(1):				
Prudential Agents	$ 22	$ 21	$ 66	$ 62
Third party	76	49	202	141
Total	$ 98	$ 70	$ 268	$ 203

(1) Annualized scheduled premiums plus 10% of excess (unscheduled) and single premiums from new sales. Excludes corporate-owned life insurance.

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2012 to 2011 Three Month Comparison. Sales of new life insurance, measured as described above, increased $28 million, from $70 million in the third quarter of 2011 to $98 million in the third quarter of 2012, primarily driven by increased sales in the third party distribution channel. This reflected a $31 million increase in sales of universal life insurance products driven by a change in the competitive position of our products, partially offset by a $4 million decrease in variable life insurance product sales.

2012 to 2011 Nine Month Comparison. Sales of new life insurance, measured as described above, increased $65 million, from $203 million in the first nine months of 2011 to $268 million in the first nine months of 2012, primarily driven by increased sales in the third party distribution channel. This primarily resulted from a $73 million increase in sales of universal life insurance products, driven by a change in the competitive position of our products.

Policy Surrender Experience

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	($ in millions)			
Cash value of surrenders	$ 165	$ 148	$ 489	$ 623
Cash value of surrenders as a percentage of mean future policy benefit reserves, policyholders’ account balances, and separate account balances	2.6%	2.5%	2.7%	3.6%

2012 to 2011 Three Month Comparison. The total cash value of surrenders increased $17 million, from $148 million in the third quarter of 2011 to $165 million in the third quarter of 2012. The level of surrenders as a percentage of mean future policy benefit reserves, policyholders’ account balances and separate account balances for the third quarter of 2012 was relatively unchanged from the third quarter of 2011.

2012 to 2011 Nine Month Comparison. The total cash value of surrenders decreased $134 million, from $623 million in the first nine months of 2011 to $489 million in the first nine months of 2012, driven by the surrenders of three large variable corporate-owned life insurance policies during 2011. The level of surrenders as a percentage of mean future policy benefit reserves, policyholders’ account balances and separate account balances decreased from 3.6% in the first nine months of 2011 to 2.7% in the first nine months of 2012 as a result of these large surrenders.

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Group Insurance

Operating Results

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

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(in millions)			
Operating results:				
Revenues	$ 1,420	$ 1,447	$ 4,203	$ 4,222
Benefits and expenses	1,385	1,402	4,175	4,101
Adjusted operating income	35	45	28	121
Realized investment gains (losses), net, and related adjustments(1)	(2)	12	(8)	14
Related charges(2)	0	0	0	(1)
Income from continuing operations before income taxes and equity in earnings of operating joint ventures	$ 33	$ 57	$ 20	$ 134

(1) Revenues exclude Realized investment gains (losses), net, and related adjustments. See “—Realized Investment Gains and Losses.”
(2) Benefits and expenses exclude charges which represent the unfavorable (favorable) impact of Realized investment gains (losses), net, on interest credited to policyholders’ account balances.

Adjusted Operating Income

2012 to 2011 Three Month Comparison. Adjusted operating income decreased $10 million, from $45 million in the third quarter of 2011 to $35 million in the third quarter of 2012. Reserve refinements in both group life and disability businesses, including the impact of annual actuarial assumption updates, contributed a $7 million benefit to adjusted operating income in the third quarter of 2012 compared to a benefit of $22 million in the third quarter of 2011. Excluding the impact of these reserve refinements, adjusted operating income increased $5 million reflecting improved investment income in the third quarter of 2012 primarily from alternative investments and mortgage loan prepayments. Underwriting results in the third quarter of 2012 for our group life business partially offset this increase reflecting less favorable claims experience in our non-retrospectively experience-rated contracts, primarily driven by increased severity, largely offset by lower claims incidence. Results for our group disability business were relatively unchanged from the third quarter of 2011.

2012 to 2011 Nine Month Comparison. Adjusted operating income decreased $93 million, from $121 million in the first nine months of 2011 to $28 million in the first nine months of 2012. Reserve refinements in both group life and disability businesses, including the impact of annual actuarial assumption updates, contributed a $7 million benefit to adjusted operating income in the first nine months of 2012 compared to a benefit of $22 million in the first nine months of 2011. In addition, updates to premium tax estimates provided a $17 million unfavorable impact to the results for the first nine months of 2012 as compared to the first nine months of 2011. Excluding the impact of these reserve refinements and premium tax updates, adjusted operating income decreased $61 million reflecting less favorable underwriting results in our group disability business primarily related to an increase in the number and severity of long-term disability claims reflecting the continued distressed economic conditions. The decrease in adjusted operating income also reflects higher general and administrative expenses in the first nine months of 2012 driven by higher operating costs. Additionally, results for the first nine months of 2012 in our group life business reflects unfavorable claims experience on non-retrospectively experience-rated contracts resulting from an increase in severity in the first quarter of 2012, as compared to a benefit of $9 million in the first nine months of 2011 from a cumulative premium adjustment relating to prior periods on a non-retrospectively experience-rated case. Partially offsetting these decreases was improved investment income in the first nine months of 2012.

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Revenues

2012 to 2011 Three Month Comparison. Revenues, as shown in the table above under “—Operating Results,” decreased $27 million, from $1,447 million in the third quarter of 2011 to $1,420 million in the third quarter of 2012. Group life premiums and policy charges and fee income decreased $54 million, from $1,064 million in the third quarter of 2011 to $1,010 million in the third quarter of 2012 reflecting lower premiums from retrospectively experience-rated contracts resulting from the decrease in policyholder benefits on these contracts, as discussed below. In addition, persistency declined from 96.2% in the third quarter of 2011 to 94.5% in the third quarter of 2012. Partially offsetting this decrease are higher premiums from non-retrospectively experience-rated contracts resulting from growth in the business.

Additionally, group disability premiums and policy charges and fee income increased $13 million, from $218 million in the third quarter of 2011 to $231 million in the third quarter of 2012 reflecting growth of in force business and new sales. Investment income also increased in the third quarter of 2012 primarily from income on alternative investments, mortgage loan prepayments and higher invested assets, due to business growth, partially offset by a decline in reinvestment rates.

2012 to 2011 Nine Month Comparison. Revenues, as shown in the table above under “—Operating Results,” decreased $19 million, from $4,222 million in the first nine months of 2011 to $4,203 million in the first nine months of 2012. Group life premiums and policy charges and fee income decreased $77 million, from $3,066 million in the first nine months of 2011 to $2,989 million in the first nine months of 2012 primarily driven by lower premiums from retrospectively experience-rated contracts resulting from the decrease in policyholder benefits on these contracts, as discussed below. Partially offsetting this decrease are higher premiums from non-retrospectively experience-rated contracts resulting from growth in the business, partially offset by a $9 million benefit from a cumulative premium adjustment related to prior periods on a large group life non-retrospectively experience-rated case, as discussed above.

Additionally, group disability premiums and policy charges and fee income increased $34 million, from $659 million in the first nine months of 2011 to $693 million in the first nine months of 2012 reflecting growth of in force business and new sales. In addition, investment income increased in the first nine months of 2012 reflecting higher income from alternative investments, mortgage loan prepayments and higher invested assets, due to business growth, partially offset by a decline in reinvestment rates.

Benefits and Expenses

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	**2011**	**2012**	**2011**
Benefits ratio(1):				
Group life	90.7%	89.3%	91.5%	90.6%
Group disability	93.9%	94.0%	97.8%	91.5%
Administrative operating expense ratio(2):				
Group life	9.2%	8.7%	9.4%	8.3%
Group disability	23.8%	25.2%	24.3%	24.6%

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

2012 to 2011 Three Month Comparison. Benefits and expenses, as shown in the table above under “—Operating Results,” decreased $17 million, from $1,402 million in the third quarter of 2011 to $1,385 million in the third quarter of 2012. This decrease reflects a $22 million decline in policyholders’ benefits, including the

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change in policy reserves, from $1,156 million in the third quarter of 2011 to $1,134 million in the third quarter of 2012. Our group life business reflects a decrease in benefit costs from retrospectively experience-rated contracts that resulted in decreased premiums, as discussed above. Partially offsetting this decrease are greater benefit costs on non-retrospectively experience-rated business due to less favorable claims experience, as well as the unfavorable variance from reserve refinements, reflecting the impact of annual actuarial assumption updates, as discussed above. Our group disability business reflects an increase in policyholders’ benefits primarily from an increase in the number and severity of long-term disability claims partially offset by an increase in claim terminations.

The group life benefits ratio deteriorated 1.4 percentage points from the third quarter of 2011 to the third quarter of 2012 primarily due to less favorable claims experience in the non-retrospectively experience-rated business and the unfavorable variance from reserve refinements, reflecting the impact of annual actuarial assumption updates, as discussed above. The group disability benefits ratio was relatively unchanged from the third quarter of 2011. The group life administrative operating expense ratio deteriorated 0.5 percentage points from the third quarter of 2011 to the third quarter of 2012 primarily due to an increase in operating costs. The group disability administrative operating expense ratios improved 1.4 percentage points from the third quarter of 2011 to the third quarter of 2012 primarily due to an increase in premiums from business growth.

2012 to 2011 Nine Month Comparison. Benefits and expenses, as shown in the table above under “—Operating Results,” increased $74 million, from $4,101 million in the first nine months of 2011 to $4,175 million in the first nine months of 2012. This increase reflects a $32 million increase in policyholders’ benefits, including the change in policy reserves, from $3,383 million in the first nine months of 2011 to $3,415 million in the first nine months of 2012. Our group disability business reflects an increase in policyholders’ benefits primarily from an increase in the number and severity of long-term disability claims and growth in the business. Also contributing to the increase in benefits and expenses are higher general and administrative expenses driven by higher costs, primarily related to premium tax estimates, as discussed above. Our group life business reflects a decrease in benefit costs primarily from retrospectively experience-rated contracts that resulted in decreased premiums, as discussed above. This was partially offset by unfavorable claims experience from an increase in severity in the first quarter of 2012 and an increase in benefits from growth in the non-retrospectively experience-rated business, as well as the unfavorable variance from reserve refinements, reflecting the impact of annual actuarial assumption updates, as discussed above.

The group life benefits ratio deteriorated 0.9 percentage points from the first nine months of 2011 to the first nine months of 2012, primarily due to unfavorable claims experience reflecting an increase in severity in the first quarter of 2012, partially offset by lower claim incidence on non-retrospectively experience-related contracts. The group disability benefits ratio deteriorated 6.3 percentage points from the first nine months of 2011 to the first nine months of 2012 primarily due to an increase in the number and severity of long-term disability claims. The group life administrative operating expense ratio deteriorated 1.1 percentage points from the first nine months of 2011 to the first nine months of 2012 primarily due to the unfavorable comparative impact of updates to premium tax estimates and an increase in operating costs. The group disability administrative operating expense ratio was relatively unchanged from the first nine months of 2011.

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Sales Results

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Annualized new business premiums(1):				
Group life	$ 18	$ 23	$ 253	$ 437
Group disability(2)	28	17	128	129
Total	$ 46	$ 40	$ 381	$ 566

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

2012 to 2011 Three Month Comparison. Total annualized new business premiums increased $6 million, from $40 million in the third quarter of 2011 to $46 million in the third quarter of 2012 resulting from increased long-term disability sales to existing clients, partially offset by lower premiums in group life associated with the assumption of existing liabilities from third parties.

2012 to 2011 Nine Month Comparison. Total annualized new business premiums decreased $185 million, from $566 million in the first nine months of 2011 to $381 million in the first nine months of 2012 primarily driven by group life sales reflecting the impact of a large market case sale to a new customer in the first nine months of 2011. Group disability sales were relatively unchanged.

International Insurance Division

Foreign Currency Exchange Rate Movements and Related Hedging Strategies

As a U.S.-based company with significant business operations outside the U.S., particularly in Japan, we are subject to foreign currency exchange rate movements that could impact our U.S. dollar-equivalent shareholder return on equity. We seek to mitigate this impact through various hedging strategies, including the use of derivative contracts and through holding U.S. dollar-denominated assets in certain of our foreign subsidiaries.

The operations of our International Insurance Division are subject to currency fluctuations that can materially affect their U.S. dollar-equivalent earnings from period to period, even if earnings on a local currency basis are relatively constant. We enter into forward currency derivative contracts, and hold “dual currency” and “synthetic dual currency” investments, as part of our strategy to effectively fix the currency exchange rates for a portion of our prospective non-U.S. dollar-denominated earnings streams, thereby reducing earnings volatility from foreign currency exchange rate movements. The forward currency hedging program is primarily associated with our insurance operations in Japan and Korea. In addition, our Japanese insurance operations offer a variety of non-yen denominated products which are supported by investments in corresponding currencies. While these non-yen denominated assets and liabilities are economically hedged, the accounting for changes in the value of these assets and liabilities due to changes in foreign currency exchange rate movements differs, resulting in volatility in reported U.S. GAAP earnings. For further information on the various hedging strategies used to mitigate the risks of foreign currency exchange rate movements on earnings, see “—Impact of foreign currency exchange rate movements on earnings.”

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In the second quarter of 2012, we refined our yen hedging strategy to calibrate the level of hedges to preserve the relative contribution of the yen-based business to the Company’s overall return on equity. This refinement did not result in a material change to the aggregate level of income and equity hedges that existed under the previous hedging strategy. Our existing hedges include a variety of instruments, including U.S. dollar-denominated assets held locally by our Japanese insurance subsidiaries financed by the combination of U.S. GAAP equity and yen-denominated liabilities. We may also hedge using instruments held in our U.S. domiciled entities, such as U.S. dollar-denominated debt that has been swapped to yen.

The table below presents the aggregate amount of instruments that serve to hedge the impact of foreign currency exchange movements on our U.S. dollar-equivalent shareholder return on equity from our Japanese insurance subsidiaries for the periods indicated.

	September 30, 2012	December 31, 2011
	(in billions)	
Instruments hedging foreign currency exchange rate exposure on U.S. dollar-equivalent earnings:		
Forward currency hedging program(1)	$ 3.0	$ 2.5
Dual currency and synthetic dual currency investments(2)	1.0	1.0
	4.0	3.5
Instruments hedging foreign currency exchange rate exposure on U.S. dollar-equivalent equity:		
Available-for-sale U.S. dollar-denominated investments, at amortized cost	7.0	6.8
Held-to-maturity U.S. dollar-denominated investments, at amortized cost	0.3	0.3
Other(1)	0.1	0.1
U.S. dollar-denominated assets held in yen-based entities(3)	7.4	7.2
Yen-denominated liabilities held in U.S. dollar-based entities(4)	0.8	0.8
	8.2	8.0
Total hedges	$ 12.2	$ 11.5
Total U.S. GAAP equity of Japanese insurance subsidiaries, as adjusted(5)	$ 9.6	$ 9.5

(1) Represents the notional amount of forward currency contracts outstanding.
(2) Represents the present value of future cash flows, on a U.S. dollar-denominated basis.
(3) Excludes $26.4 billion and $23.7 billion as of September 30, 2012 and December 31, 2011, respectively, of U.S. dollar assets supporting U.S. dollar liabilities related to U.S. dollar-denominated products issued by our Japanese insurance operations.
(4) The yen-denominated liabilities are reported in Corporate and Other operations.
(5) Excludes “Accumulated other comprehensive income (loss)” components of equity and certain other adjustments.

The U.S. dollar-denominated investments that hedge the U.S. dollar-equivalent shareholder return on equity from our Japanese insurance operations are recorded on the books of yen-based entities and, as a result, foreign currency exchange rate movements will impact their value. To the extent the value of the yen strengthens as compared to the U.S. dollar, the value of these U.S. dollar-denominated investments will decrease. We seek to mitigate the risk that future unfavorable foreign currency exchange rate movements will decrease the value of our U.S. dollar-denominated investments and negatively impact the equity of, and therefore, the local solvency margins of, our yen-based entities by employing internal hedging strategies between a subsidiary of Prudential Financial and certain of our yen-based entities. These have the economic effect of moving the hedges from our Japanese yen-based entities to our U.S. dollar-based entities. See “—Liquidity and Capital Resources—Liquidity and Capital Resources of Subsidiaries—International Insurance Subsidiaries” for a discussion of our internal hedging strategies.

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These U.S. dollar-denominated investments also pay a coupon which is generally higher than what a similar yen-denominated investment would pay. The incremental impact of this higher yield on our U.S. dollar-denominated investments, as well as our dual currency and synthetic dual currency investments discussed below, will vary over time, and is dependent on the duration of the underlying investments, as well as interest rate environments in the U.S. and Japan at the time of the investments. See “—General Account Investments—Investment Results” for a discussion of the investment yields generated by our Japanese insurance operations.

Impact of foreign currency exchange rate movements on earnings

Forward currency hedging program

The financial results of our International Insurance segment for all periods presented reflect the impact of an intercompany arrangement with Corporate and Other operations pursuant to which the segment’s non-U.S. dollar-denominated earnings in certain countries are translated at fixed currency exchange rates. The fixed rates are determined in connection with a foreign currency income hedging program designed to mitigate the impact of exchange rate changes on the segment’s U.S. dollar-equivalent earnings. Pursuant to this program, Corporate and Other operations execute forward currency contracts with third parties to sell the net exposure of projected earnings from the hedged currency in exchange for U.S. dollars at specified exchange rates. The maturities of these contracts correspond with the future periods in which the identified non-U.S. dollar-denominated earnings are expected to be generated. In establishing the level of non-U.S. dollar-denominated earnings that will be hedged through this program, we exclude the anticipated level of U.S. dollar-denominated earnings that will be generated by dual currency and synthetic dual currency investments, as well as the anticipated level of U.S. dollar-denominated earnings that will be generated by U.S. dollar-denominated products and investments, both of which are discussed in greater detail below. As a result of this intercompany arrangement, our International Insurance segment results for 2011 reflect the impact of translating yen and Korean won-denominated earnings at fixed currency exchange rates of 92 yen per U.S. dollar and 1190 Korean won per U.S. dollar. Results for 2012 reflect the impact of translating yen and Korean won-denominated earnings at fixed currency exchange rates of 85 yen per U.S. dollar and 1180 Korean won per U.S. dollar.

Results of Corporate and Other operations include any differences between the translation adjustments recorded by the segment at the fixed currency exchange rate versus the actual average rate during the period, and the gains or losses recorded from the forward currency contracts that settled during the period, which include the impact of any over or under hedging of actual earnings that differ from projected earnings. The table below presents, for the periods indicated, the increase (decrease) to revenues and adjusted operating income for the International Insurance segment and for Corporate and Other operations, reflecting the impact of this intercompany arrangement.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)		(in millions)	
International Insurance Segment:				
Impact of intercompany arrangement(1)	$ (27)	$ (56)	$ (70)	$ (129)
Corporate and Other operations:				
Impact of intercompany arrangement(1)	27	56	70	129
Settlement gains (losses) on forward currency contracts	(18)	(41)	(66)	(107)
Net benefit (detriment) to Corporate and Other operations	9	15	4	22
Net impact on consolidated revenues and adjusted operating income	$ (18)	$ (41)	$ (66)	$ (107)

(1) Represents the difference between non-U.S. dollar-denominated earnings translated on the basis of weighted average monthly currency exchange rates versus fixed currency exchange rates determined in connection with the forward currency hedging program.

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As of September 30, 2012 and December 31, 2011, the notional amounts of these forward currency contracts were $3.6 billion and $3.0 billion, respectively, of which $3.0 billion and $2.5 billion, respectively, were related to our Japanese insurance operations.

Dual currency and synthetic dual currency investments hedging program

In addition, our Japanese insurance operations hold dual currency investments in the form of fixed maturities and loans. The principal of these dual currency investments is yen-denominated while the related interest income is U.S. dollar-denominated. These investments are the economic equivalent of exchanging what would otherwise be fixed streams of yen-denominated interest income for fixed streams of U.S. dollar-denominated interest income. Our Japanese insurance operations also hold yen-denominated investments that have been coupled with cross-currency coupon swap agreements, creating synthetic dual currency investments. The yen/U.S. dollar exchange rate is effectively fixed, as we are obligated in future periods to exchange fixed amounts of yen interest payments generated by the yen-denominated investments for fixed amounts of U.S. dollar interest payments at the yen/U.S. dollar exchange rates specified by the cross-currency coupon swap agreements. As of September 30, 2012 and December 31, 2011, the notional amount of these investments was ¥237 billion, or $2.2 billion, and ¥280 billion, or $2.5 billion, respectively, based upon the foreign currency exchange rates applicable at the time these investments were acquired. The weighted average yields generated by these investments were 3.4% for both the three and nine months ended September 30, 2012, and 2.9% and 3.0% for the three and nine months ended September 30, 2011, respectively.

Below is the fair value of these instruments as reflected on our balance sheet for the periods indicated.

	September 30, 2012	December 31, 2011
	(in millions)	
Cross-currency coupon swap agreements	$ (64)	$ (105)
Foreign exchange component of interest on dual currency investments	(117)	(128)
Total	$ (181)	$ (233)

U.S. GAAP earnings impact of products denominated in non-local currencies

Our international insurance operations primarily offer products denominated in local currency. However, several of our international insurance operations, most notably our Japanese operations, also offer products denominated in non-local currencies, primarily comprised of U.S. and Australian dollar-denominated products. The non-yen denominated insurance liabilities related to these products are supported by investments denominated in corresponding currencies, including a significant portion designated as available-for-sale. While these non-yen denominated assets and liabilities are economically hedged, the accounting for changes in the value of these assets and liabilities due to changes in foreign currency exchange rate movements differs, resulting in volatility in U.S. GAAP earnings. For example, unrealized gains and losses on available-for-sale investments, including those arising from foreign currency exchange rate movements, are recorded in “Accumulated other comprehensive income (loss),” whereas the non-yen denominated liabilities are remeasured for foreign currency exchange rate movements, and the related changes in value are recorded in earnings within “Asset management fees and other income.” Investments designated as held-to-maturity under U.S. GAAP, are recorded at amortized cost on the balance sheet, but are remeasured for foreign currency exchange rate movements, with the related change in value recorded in earnings within “Asset management fees and other income.” Due to this non-economic volatility that is reflected in U.S. GAAP earnings, the gains and losses resulting from the remeasurement of these non-yen denominated liabilities, and certain related non-yen denominated assets, are excluded from adjusted operating income and included in “Realized investment gains (losses), net, and related adjustments.” For the three and nine months ended September 30, 2012, “Realized investment gains (losses), net, and related adjustments” includes net losses of $384 million and $191 million, respectively, reflecting the remeasurement of these non-yen denominated insurance liabilities, which are presented in the table below, and the remeasurement of certain related non-yen denominated assets. These net losses were primarily driven by the weakening of the yen against both the Australian and U.S. dollar.

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The table below presents the carrying value of insurance liabilities related to products offered in non-local currencies within our Japanese insurance operations as of the periods indicated.

	September 30, 2012	December 31, 2011
	(in billions)	
U.S. dollar-denominated products	$ 25.3	$ 23.4
Australian dollar-denominated products	7.9	6.2
Euro-denominated products	0.3	0.2
Total	$ 33.5	$ 29.8

As of September 30, 2012 and December 31, 2011, $5.4 billion and $4.5 billion, respectively, of insurance liabilities for U.S. dollar-denominated products presented in the table above are associated with Prudential of Japan and coinsured to our U.S. domiciled insurance entities. These U.S. dollar-denominated liabilities are supported by U.S. dollar-denominated assets and are not subject to the remeasurement mismatch described above.

International Insurance

Operating Results

The results of our International Insurance operations are translated on the basis of weighted average monthly exchange rates, inclusive of the effects of the intercompany arrangement discussed above. To provide a better understanding of operating performance within the International Insurance segment, where indicated below, we have analyzed our results of operations excluding the effect of the year over year change in foreign currency exchange rates. Our results of operations excluding the effect of foreign currency fluctuations were derived by translating foreign currencies to U.S. dollars at uniform exchange rates for all periods presented, including for constant dollar information discussed below. The exchange rates used were Japanese yen at a rate of 85 yen per U.S. dollar and Korean won at a rate of 1180 won per U.S. dollar, both of which were determined in connection with the foreign currency income hedging program discussed above. In addition, for constant dollar information discussed below, activity denominated in U.S. dollars is generally reported based on the amounts as transacted in U.S. dollars. Annualized new business premiums presented on a constant exchange rate basis in the “Sales Results” section below reflect translation based on these same uniform exchange rates.

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

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(in millions)			
Operating results:				
Revenues:				
Life Planner operations	$ 2,237	$ 2,076	$ 6,746	$ 6,117
Gibraltar Life and Other operations	5,942	3,054	13,713	8,382
	8,179	5,130	20,459	14,499
Benefits and expenses:				
Life Planner operations	1,844	1,745	5,597	5,171
Gibraltar Life and Other operations	5,552	2,725	12,792	7,540
	7,396	4,470	18,389	12,711
Adjusted operating income:				
Life Planner operations	393	331	1,149	946
Gibraltar Life and Other operations	390	329	921	842
	783	660	2,070	1,788
Realized investment gains (losses), net, and related adjustments(1)	(483)	1,366	(443)	879
Related charges(2)	(17)	(12)	(38)	(12)
Investment gains (losses) on trading account assets supporting insurance liabilities, net(3)	(4)	(109)	66	(136)
Change in experience-rated contractholder liabilities due to asset value changes(4)	4	109	(66)	136
Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests(5)	(64)	(100)	(77)	(267)
Income from continuing operations before income taxes and equity in earnings of operating joint ventures	$ 219	$ 1,914	$ 1,512	$ 2,388

(1) Revenues exclude Realized investment gains (losses), net, and related adjustments. Realized investment gains (losses), net, and related adjustments includes gains and losses from changes in value of certain assets and liabilities relating to foreign currency exchange movements that have been economically hedged, as discussed above. See “—Realized Investment Gains and Losses.”

(2) Revenues exclude charges resulting from payments related to market value adjustment features of certain of our annuity products and the impact of Realized investment gains (losses), net, on the amortization of unearned revenue reserves. Benefits and expenses exclude charges that represent the element of “Dividends to policyholders” that is based on a portion of certain realized investment gains required to be paid to policyholders and the impact of Realized investment gains (losses), net, on the amortization of deferred policy acquisition costs.

(3) Revenues exclude net investment gains and losses on trading account assets supporting insurance liabilities. See “—Experience-Rated Contractholder Liabilities, Trading Account Assets Supporting Insurance Liabilities and Other Related Investments.”

(4) Benefits and expenses exclude changes in contractholder liabilities due to asset value changes in the pool of investments supporting these experience-rated contracts. See “—Experience-Rated Contractholder Liabilities, Trading Account Assets Supporting Insurance Liabilities and Other Related Investments.”

(5) Equity in earnings of operating joint ventures are included in adjusted operating income but excluded from income from continuing operations before income taxes and equity in earnings of operating joint ventures as they are reflected on a U.S. GAAP basis on an after-tax basis as a separate line in our Unaudited Interim Consolidated Statements of Operations. Earnings attributable to noncontrolling interests are excluded from adjusted operating income but included in income from continuing operations before taxes and equity earnings of operating joint ventures as they are reflected on a U.S. GAAP basis as a separate line in our Unaudited Interim Consolidated Statements of Operations. Earnings attributable to noncontrolling interests represent the portion of earnings from consolidated entities that relates to the equity interests of minority investors.

Integration of Star and Edison

We have made significant progress integrating the acquired former Star and Edison businesses with Gibraltar Life and, as a result, have reduced our expected pre-tax integration costs by $50 million and now anticipate incurring approximately $450 million of total integration costs. In aggregate, we have incurred $303 million of pre-tax integration costs, of which $174 million was in 2011 and $129 million was in the first nine months of 2012. After integration is complete, we continue to expect annual cost savings of approximately $250 million, and to achieve two-thirds of the annual savings by the end of 2012. Actual integration costs may exceed, and actual cost savings may fall short of, such expectations.

Adjusted Operating Income

2012 to 2011 Three Month Comparison. Adjusted operating income from our Life Planner operations increased $62 million, from $331 million in the third quarter of 2011 to $393 million in the third quarter of 2012, including a net favorable impact of $14 million from currency fluctuations. The current quarter includes a $20 million benefit from a reduction in the amortization of deferred policy acquisition costs and lower reserves, reflecting the impact of our annual review and update of assumptions used in estimating the profitability of our business. Excluding the impact from these items, adjusted operating income of our Life Planner operations increased $28 million driven by the continued growth of business in force, strong persistency in our Japanese Life Planner operations and, to a lesser extent, higher net spread earnings reflecting the impact of portfolio growth and crediting rate declines, offset by the impact of lower reinvestment rates.

Adjusted operating income from our Gibraltar Life and Other operations increased $61 million, from $329 million in the third quarter of 2011 to $390 million in the third quarter of 2012, including a favorable impact of $13 million from currency fluctuations. Integration costs relating to the acquisition of the Star and Edison Businesses were $34 million in the current year quarter, reflecting a decrease of $9 million from the prior year quarter. Adjusted operating income for both periods reflect the impact of partial sales of our investment, through a consortium, in China Pacific Group, which contributed a $60 million benefit to the current quarter compared to an $84 million benefit in the prior year quarter. As of September 30, 2012, the value of our indirect investment in China Pacific Group was $62 million, including an unrealized gain of $48 million. There are no restrictions on the consortium of investors from selling its remaining interest in China Pacific Group.

Excluding the effect of the items discussed above, adjusted operating income from our Gibraltar Life and Other operations increased $63 million, primarily reflecting business growth across all distribution channels, as well as a $41 million benefit from cost savings resulting from Star and Edison integration synergies in the current quarter compared to $6 million in the year ago quarter. Additionally, adjusted operating income for the current quarter reflects greater contributions from investment results driven by favorable impacts from our equity method investments and portfolio growth, largely offset by lower yields on our investment portfolio compared to the prior year.

2012 to 2011 Nine Month Comparison. Adjusted operating income from Life Planner operations increased $203 million, from $946 million in the first nine months of 2011 to $1,149 million in the first nine months of 2012, including a net favorable impact of $41 million from currency fluctuations. The current quarter benefitted $20 million from a reduction in the amortization of deferred policy acquisition costs and lower reserves, reflecting the impact of our annual review and update of assumptions used in estimating the profitability of our business. In addition, the increase in adjusted operating income includes a $19 million benefit reflecting the comparative impact of a $13 million charge in the 2011 period associated with estimated claims and expenses arising from the earthquake in Japan, and a $6 million benefit in the current year period resulting from a cash distribution received from the Japan Financial Stability Fund. Excluding the impact of these items, adjusted operating income for our Life Planner operations increased $123 million, primarily reflecting the growth of business in force driven by sales results and continued strong persistency in our Japanese Life Planner operations.

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Adjusted operating income from our Gibraltar Life and Other operations increased $79 million, from $842 million in the first nine months of 2011 to $921 million in the first nine months of 2012, including a favorable impact of $35 million from currency fluctuations. The increase in adjusted operating income reflects the absence of a $56 million charge recognized in the prior year period associated with estimated claims and expenses arising from the 2011 earthquake in Japan, as well as a $33 million benefit in the current year resulting from a cash distribution received from the Japan Financial Stability Fund. Partly offsetting these favorable variances is a $34 million charge in the current year associated with an agreement entered into with DLF Ltd., or “DLF,” relating to our life insurance joint venture with DLF in India, for certain obligations to DLF in connection with the continuation of that venture with a potential new partner. Additionally, results for the first nine months of 2012 include $129 million of integration costs relating to the acquisition of the Star and Edison Businesses, compared to $119 million of integration and transaction costs in the prior year period. Both periods benefited from the impact of partial sales of our investment, through a consortium, in China Pacific Group, which contributed $60 million in the current year period compared to $237 million in the prior year period.

Excluding the effect of the items discussed above, adjusted operating income from our Gibraltar Life and Other operations increased $176 million, primarily reflecting business growth across all distribution channels, including greater contributions from our cancer whole life products due to increased sales, and cost savings of $112 million resulting from Star and Edison integration synergies, compared to $13 million of cost savings in the year ago period. In addition, the current year benefit resulting from the impact of including two additional months of earnings from the former Star and Edison Businesses was largely offset by lower yields on our investment portfolio and higher policy benefits and expenses.

Revenues

2012 to 2011 Three Month Comparison. Revenues, as shown in the table above under “—Operating Results,” increased $3,049 million, from $5,130 million in the third quarter of 2011 to $8,179 million in the third quarter of 2012, including a net favorable impact of $171 million relating to currency fluctuations. Excluding the impact of currency fluctuations, revenues increased $2,878 million, from $4,920 million in the third quarter of 2011 to $7,798 million in the third quarter of 2012.

Revenues from our Life Planner operations increased $161 million, from $2,076 million in the third quarter of 2011 to $2,237 million in the third quarter of 2012, including a net unfavorable impact of $15 million from currency fluctuations. Excluding the impact of currency fluctuations, revenues increased $176 million, from $1,997 million in the third quarter of 2011 to $2,173 million in the third quarter of 2012. This increase in revenues came primarily from increases in premiums and policy charges and fee income of $130 million driven by growth of business in force and continued strong persistency. Net investment income increased $46 million primarily due to investment portfolio growth, partially offset by lower yields in our investment portfolio compared to the prior year period.

Revenues from our Gibraltar Life and Other operations increased $2,888 million, from $3,054 million in the third quarter of 2011 to $5,942 million in the third quarter of 2012, including a net favorable impact of $186 million from currency fluctuations. Excluding the impact of currency fluctuations, revenues increased $2,702 million, from $2,923 million in the third quarter of 2011 to $5,625 million in the third quarter of 2012. This increase reflects a $2,671 million increase in premiums and policy charges and fee income primarily driven by growth in the bank distribution channel, including $2,710 million of higher premiums from sales of yen-denominated single premium whole life policies. Also contributing to the increase in revenues is higher net investment income of $72 million primarily reflecting investment portfolio growth and favorable results from our equity method investments, partly offset by lower yields in comparison to the prior year quarter. Partially offsetting these increases is lower asset management fees and other income driven by the impact of partial sales, in both comparative periods, of our indirect investment in China Pacific Group, as discussed above.

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2012 to 2011 Nine Month Comparison. Revenues increased $5,960 million, from $14,499 million in the first nine months of 2011 to $20,459 million in the first nine months of 2012, including a net favorable impact of $475 million relating to currency fluctuations. Excluding the impact of currency fluctuations, revenues increased $5,485 million, from $14,140 million in the first nine months of 2011 to $19,625 million in the first nine months of 2012.

Revenues from our Life Planner operations increased $629 million, from $6,117 million in the first nine months of 2011 to $6,746 million in the first nine months of 2012, including a net favorable impact of $22 million from currency fluctuations. Excluding the impact of currency fluctuations, revenues increased $607 million, from $5,964 million in the first nine months of 2011 to $6,571 million in the first nine months of 2012. This increase in revenues came primarily from increases in premiums and policy charges and fee income of $469 million driven by growth of business in force and continued strong persistency. Net investment income increased $117 million primarily due to investment portfolio growth, partially offset by lower yields in our investment portfolio compared to the prior year period.

Revenues from our Gibraltar Life and Other operations increased $5,331 million, from $8,382 million in the first nine months of 2011 to $13,713 million in the first nine months of 2012, including a net favorable impact of $453 million from currency fluctuations. Excluding the impact of currency fluctuations, revenues increased $4,878 million, from $8,176 million in the first nine months of 2011 to $13,054 million in the first nine months of 2012. This increase reflects a $4,734 million increase in premiums and policy charges and fee income reflecting growth in the bank distribution channel, including $3,865 million of higher premiums from sales of yen-denominated single premium whole life policies, as well as higher renewal premiums of $760 million in the Life Consultant distribution channel. Also contributing to the increase in revenues is higher net investment income of $308 million primarily reflecting investment portfolio growth, partially offset by lower investment portfolio yields. Asset management fees and other income declined compared to the prior year period primarily driven by the impact of partial sales of our indirect investment in China Pacific Group, resulting in a $60 million gain in the current year period compared to a $237 million gain in the prior year period. This impact is partially offset by the $33 million benefit related to the distribution received in the current year period from the Japan Financial Stability Fund.

Benefits and Expenses

2012 to 2011 Three Month Comparison. Benefits and expenses, as shown in the table above under “—Operating Results,” increased $2,926 million, from $4,470 million in the third quarter of 2011 to $7,396 million in the third quarter of 2012, including a net unfavorable impact of $144 million related to currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased $2,782 million, from $4,198 million in the third quarter of 2011 to $6,980 million in the third quarter of 2012.

Benefits and expenses of our Life Planner operations increased $99 million, from $1,745 million in the third quarter of 2011 to $1,844 million in the third quarter of 2012, including a net favorable impact of $29 million from currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased $128 million, from $1,639 million in the third quarter of 2011 to $1,767 million in the third quarter of 2012. Benefits and expenses of our Japanese Life Planner operations increased $89 million, primarily reflecting an increase in policyholder benefits due to changes in reserves driven by the growth in business in force. The current quarter also benefitted from a $20 million reduction in the amortization of deferred policy acquisition costs and lower reserves, reflecting the impact of our annual review and update of assumptions used in estimating the profitability of our business.

Benefits and expenses of our Gibraltar Life and Other operations increased $2,827 million, from $2,725 million in the third quarter of 2011 to $5,552 million in the third quarter of 2012, including an unfavorable impact of $173 million from currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased $2,654 million, from $2,559 million in the third quarter of 2011 to

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$5,213 million in the third quarter of 2012. Policyholder benefits, including changes in reserves, increased $2,660 million primarily driven by higher sales of yen-denominated single premium whole life policies in the current quarter. This is partly offset by lower general and administrative expenses, net of capitalization, driven by cost savings in the current year quarter resulting from Star and Edison integration synergies.

2012 to 2011 Nine Month Comparison. Benefits and expenses increased $5,678 million, from $12,711 million in the first nine months of 2011 to $18,389 million in the first nine months of 2012, including a net unfavorable impact of $399 million related to currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased $5,279 million, from $12,197 million in the first nine months of 2011 to $17,476 million in the first nine months of 2012.

Benefits and expenses of our Life Planner operations increased $426 million, from $5,171 million in the first nine months of 2011 to $5,597 million in the first nine months of 2012, including a net favorable impact of $19 million from currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased $445 million, from $4,948 million in the first nine months of 2011 to $5,393 million in the first nine months of 2012. Benefits and expenses of our Japanese Life Planner operations increased $363 million, primarily reflecting an increase in policyholder benefits due to changes in reserves driven by the growth in business in force, partially offset by the absence of charges recognized in the prior year period associated with estimated claims from the 2011 earthquake in Japan. Additionally, the current period includes a $20 million benefit from a reduction in the amortization of deferred policy acquisition costs and lower reserves, reflecting the impact of our annual review and update of assumptions used in estimating the profitability of our business.

Benefits and expenses of our Gibraltar Life and Other operations increased $5,252 million, from $7,540 million in the first nine months of 2011 to $12,792 million in the first nine months of 2012, including an unfavorable impact of $418 million from currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased $4,834 million, from $7,249 million in the first nine months of 2011 to $12,083 million in the first nine months of 2012. Policyholder benefits, including changes in reserves, increased $4,408 million primarily driven by higher sales of yen-denominated single premium whole life products in the first nine months of 2012, partially offset by the absence of charges recognized in the prior year period associated with estimated claims from the 2011 earthquake in Japan. Higher general and administrative expenses, net of capitalization, are driven primarily by increased costs supporting business growth and the $34 million charge associated with an agreement entered into with DLF, as discussed above, partially offset by cost savings in the current year period resulting from Star and Edison integration synergies.

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Sales Results

In managing our international insurance business, we analyze revenues, as well as annualized new business premiums, which do not correspond to revenues under U.S. GAAP. Annualized new business premiums measure the current sales performance of the segment, while revenues primarily reflect the renewal persistency of policies written in prior years and net investment income, in addition to current sales. Annualized new business premiums include 10% of first year premiums or deposits from single pay products. No other adjustments are made for limited pay contracts. The following table sets forth annualized new business premiums on an actual and constant exchange rate basis for the periods indicated.

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(in millions)			
Annualized new business premiums:				
On an actual exchange rate basis:				
Life Planner operations	$ 274	$ 291	$ 1,070	$ 856
Gibraltar Life	680	570	1,911	1,487
Total	$ 954	$ 861	$ 2,981	$ 2,343
On a constant exchange rate basis:				
Life Planner operations	$ 264	$ 273	$ 1,036	$ 817
Gibraltar Life	636	537	1,810	1,424
Total	$ 900	$ 810	$ 2,846	$ 2,241

With a diversified product mix supporting the growing demand for retirement and savings products, our international insurance operations offer various traditional whole life, term, endowment (which provide for payment on the earlier of death or maturity) and retirement income life insurance products that combine an insurance protection element similar to that of term life policies with a retirement income feature. In most of our operations, we also offer certain health products with fixed benefits, some of which include a high savings element, as well as annuity products, which are primarily represented by U.S. and Australian dollar-denominated fixed annuities in our Gibraltar Life operations.

Our Life Planners’ primary objective is to sell protection-oriented life insurance products on a needs basis to mass affluent and affluent customers, as well as to small businesses, whereas Gibraltar’s Life Consultants, previously identified as Life Advisors, primarily sell individual protection products to the broad middle income market in Japan, particularly through relationships with affinity groups. Supplementing our core Life Planner and Gibraltar Life Consultant distribution channels, bank distribution channel sales primarily consist of products intended to provide premature death protection and retirement income, such as our yen-denominated single premium whole life product, as well as fixed annuity products primarily denominated in U.S. and Australian dollars. Our independent agency channel sells protection products and high cash value products for retirement benefits through the business market and sells a variety of other products including protection, medical and fixed annuity products through the individual market.

Historically, growth in annualized new business premiums was closely correlated to growth of our Life Planner and Gibraltar Life Consultant distribution force. Recently, growth in annualized new business premiums is being driven by increased average premium per new policy resulting in part from the growing demand for retirement-oriented products, as well as expanded distribution through third party channels, especially banks. As noted in the table below, bank channel sales contain a disproportionate number of single pay or limited pay contracts which tend to be larger policies and therefore have higher average premiums per policy. Our expectation is that this trend will continue.

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The amount of annualized new business premiums for any given period can be significantly impacted by several factors, including but not limited to, changes in credited interest rates for certain products and other product modifications, changes in tax laws, changes in life insurance regulations or changes in the competitive environment. Sales volume may increase or decrease prior to such changes becoming effective, and then fluctuate in the other direction following such changes.

The tables below present annualized new business premiums on a constant exchange rate basis, by product and distribution channel, for the periods indicated.

	Three Months Ended September 30, 2012					Three Months Ended September 30, 2011				
	Life	Accident & Health(1)	Retirement(2)	Annuity	Total	Life	Accident & Health(1)	Retirement(2)	Annuity	Total
					(in millions)					
Life Planners	$ 116	$ 21	$ 102	$ 25	$ 264	$ 103	$ 47	$ 109	$ 14	$ 273
Gibraltar Life:										
Life Consultants	105	28	29	31	193	110	53	39	51	253
Banks(3)	378	0	2	26	406	104	8	7	46	165
Independent Agency	16	7	10	4	37	56	35	4	24	119
Subtotal	499	35	41	61	636	270	96	50	121	537
Total	$ 615	$ 56	$ 143	$ 86	$ 900	$ 373	$ 143	$ 159	$ 135	$ 810

(1) Includes medical insurance, cancer insurance and accident & sickness riders. The three months ended September 30, 2012 and 2011 include $8 million and $50 million, respectively, of annualized new business premiums from cancer whole life insurance products.
(2) Includes retirement income, endowment and savings variable universal life.
(3) Single pay life annualized new business premiums, which include 10% of first year premiums, and 3-year limited pay annualized new business premiums, which include 100% of new business premiums, represented 84% and 13%, respectively, of total bank distribution channel annualized new business premiums, excluding annuity products, for the three months ended September 30, 2012, and 23% and 59%, respectively, of total bank distribution channel annualized new business premiums, excluding annuity products, for the three months ended September 30, 2011.

2012 to 2011 Three Month Comparison. On a constant exchange rate basis, annualized new business premiums increased $90 million, from $810 million in the third quarter of 2011 to $900 million in the third quarter of 2012.

Annualized new business premiums, on a constant exchange rate basis, from our Life Planner operations decreased $9 million, from $273 million in the third quarter of 2011 to $264 million in the third quarter of 2012, including a $27 million decline in Japan. The current period decline in Japan sales was driven by accelerated sales of cancer whole life and U.S. dollar-denominated retirement income products in the preceding quarters of 2012. The increased sales of cancer products were in advance of an April 2012 tax law change which impacted the corporate tax deductibility of premiums paid for these products, and the increased sales of U.S. dollar-denominated retirement income products were in advance of a crediting rate change effective June 2012. These unfavorable items were partly offset by higher sales of yen-denominated retirement income products in the corporate market as well as growth in Korea, Brazil, and Italy, including the introduction of new products into these markets.

Annualized new business premiums, on a constant exchange rate basis, from our Gibraltar Life operations increased $99 million, from $537 million in the third quarter of 2011 to $636 million in the third quarter of 2012. The increase in annualized new business premiums was driven by higher sales of $241 million in the bank channel driven by higher demand for our yen-denominated single premium whole life products primarily reflecting a benefit from actions taken by certain of our competitors to limit sales and lower crediting rates on these products. This benefit was partly offset by lower sales of U.S. dollar-denominated whole life and retirement

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income products as well as cancer whole life products due to an acceleration of sales to the preceding quarters of 2012. The accelerated sales of U.S. dollar-denominated whole life and retirement income products was in advance of crediting rate changes effective April 2012, and the increased sales of cancer products were in advance of the April 2012 tax law change discussed above.

	Nine Months Ended September 30, 2012					Nine Months Ended September 30, 2011				
	Life	Accident & Health(1)	Retirement(2)	Annuity	Total	Life	Accident & Health(1)	Retirement(2)	Annuity	Total
	(in millions)									
Life Planners	$ 348	$ 163	$ 466	$ 59	$ 1,036	$ 314	$ 131	$ 339	$ 33	$ 817
Gibraltar Life:										
Life Consultants	310	118	144	107	679	301	137	79	149	666
Banks(3)	710	34	10	85	839	277	33	18	108	436
Independent Agency	54	182	35	21	292	129	138	11	44	322
Subtotal	1,074	334	189	213	1,810	707	308	108	301	1,424
Total	$ 1,422	$ 497	$ 655	$ 272	$ 2,846	$ 1,021	$ 439	$ 447	$ 334	$ 2,241

(1) Includes medical insurance, cancer insurance and accident & sickness riders. The nine months ended September 30, 2012 and 2011 include $297 million and $164 million, respectively, of annualized new business premiums from cancer whole life insurance products.
(2) Includes retirement income, endowment and savings variable universal life.
(3) Single pay life annualized new business premiums, which include 10% of first year premiums, and 3-year limited pay annualized new business premiums, which include 100% of new business premiums, represented 66% and 24%, respectively, of total bank distribution channel annualized new business premiums, excluding annuity products, for the nine months ended September 30, 2012, and 27% and 52%, respectively, of total bank distribution channel annualized new business premiums, excluding annuity products, for the nine months ended September 30, 2011.

2012 to 2011 Nine Month Comparison. On a constant exchange rate basis, annualized new business premiums increased $605 million, from $2,241 million in the first nine months of 2011 to $2,846 million in the first nine months of 2012.

Annualized new business premiums, on a constant exchange rate basis, from our Life Planner operations increased $219 million, from $817 million in the first nine months of 2011 to $1,036 million in the first nine months of 2012. This increase was driven by higher sales in Japan of $185 million reflecting increased demand for U.S. dollar-denominated retirement income products in anticipation of a change in crediting rate that became effective in June 2012, higher demand for yen-denominated retirement income products in the corporate market, and increased demand for cancer products in anticipation of the tax law change enacted in April 2012. Additionally, sales increased due to growth in our operations in Brazil, Taiwan, Korea, and Italy, including the introduction of new products into these markets.

Annualized new business premiums, on a constant exchange rate basis, from our Gibraltar Life operations increased $386 million, from $1,424 million in the first nine months of 2011 to $1,810 million in the first nine months of 2012. The increase in annualized new business premiums was driven by increased sales of $403 million in the bank channel driven by increased sales of yen-denominated single premium whole life products reflecting a benefit from actions taken by certain of our competitors to limit sales and lower crediting rates on these products. Sales also benefitted from increased demand for U.S. dollar denominated whole life and retirement income products in anticipation of pricing changes in April 2012, as well as increased demand for cancer whole life products in anticipation of tax law changes for these products, as discussed above. In addition, the benefit from including two additional months of sales from the former Star and Edison businesses when compared to the previous year period was partially offset by a temporary decline in sales in January 2012 attributable to an expected disruption in productivity resulting from the merger of these businesses on January 1, 2012. Sales in 2012 were also negatively impacted by the discontinuation of certain products previously offered by Star and Edison.

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The number of Life Planners increased by 230 from 6,699 as of September 30, 2011 to 6,929 as of September 30, 2012, driven by increases of 77 and 65 in Poland and Korea, respectively, reflecting stronger recruitment and retention and 76 in Brazil due to agency growth. Also contributing to the increase in Life Planners over the past twelve months were increases of 25 in Japan, 21 in Italy, and 7 in Argentina, partly offset by a decline of 39 in Taiwan.

The number of Gibraltar Life Consultants decreased by 1,253 from 12,936 as of September 30, 2011 to 11,683 as of September 30, 2012 primarily driven by anticipated resignations and terminations of former Star and Edison Life Consultants, due in part to their failure to meet minimum sales production standards.

Corporate and Other

Corporate and Other includes corporate operations, after allocations to our business segments, and divested businesses except for those that qualify for “discontinued operations” accounting treatment under U.S. GAAP.

Corporate operations consist primarily of: (1) investment returns on capital that is not deployed in any business segments; (2) returns from investments not allocated to business segments, including debt-financed investment portfolios, and certain strategic joint venture investments, as well as tax credit investments and other tax enhanced investments financed by business segments; (3) capital debt that is used or will be used to meet the capital requirements of the Company and the related interest expense; (4) income and expense from qualified pension and other employee benefit plans, after allocations to business segments; (5) corporate-level income and expense, after allocations to business segments, including corporate governance, corporate advertising, philanthropic activities, deferred compensation, and costs related to certain contingencies; (6) certain retained obligations relating to pre-demutualization policyholders whom we had previously agreed to provide insurance for reduced or no premium in accordance with contractual settlements related to prior individual life insurance sales practices remediation; (7) results related to our Capital Protection Framework, as described below; and (8) the impact of transactions with and between other segments.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Operating results:				
Capital debt interest expense	$ (176)	$ (155)	$ (519)	$ (459)
Net investment income, net of interest expense, excluding capital debt interest expense	(12)	(20)	(38)	(15)
Pension income and employee benefits	22	56	54	139
Other corporate activities(1)	(286)	(230)	(576)	(523)
Adjusted operating income	(452)	(349)	(1,079)	(858)
Realized investment gains (losses), net, and related adjustments(2)	90	(1,312)	(9)	(1,304)
Related charges(3)	(18)	56	(15)	64
Divested businesses(4)	(685)	43	(657)	49
Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests(5)	1	3	(2)	2
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures	$ (1,064)	$ (1,559)	$ (1,762)	$ (2,047)

(1) Includes consolidating adjustments.
(2) Revenues exclude Realized investment gains (losses), net, and related adjustments. See “—Realized Investment Gains and Losses.”
(3) Benefits and expenses exclude charges which represent consolidating adjustments.
(4) See “—Divested Businesses.”

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(5) Equity in earnings of operating joint ventures are included in adjusted operating income but excluded from income from continuing operations before income taxes and equity in earnings of operating joint ventures as they are reflected on a U.S. GAAP basis on an after-tax basis as a separate line in our Unaudited Interim Consolidated Statements of Operations. Earnings attributable to noncontrolling interests are excluded from adjusted operating income but included in income from continuing operations before income taxes and equity in earnings of operating joint ventures as they are reflected on a U.S. GAAP basis as a separate line in our Unaudited Interim Consolidated Statements of Operations. Earnings attributable to noncontrolling interests represent the portion of earnings from consolidated entities that relate to the equity interests of minority investors.

2012 to 2011 Three Month Comparison. The loss from Corporate and Other operations, on an adjusted operating income basis, increased $103 million, from $349 million in the third quarter of 2011 to $452 million in the third quarter of 2012. Capital debt interest expense increased $21 million primarily due to higher levels of capital debt. Increases in net investment income, net of interest expense, excluding capital debt interest expense, of $8 million partially offset these deficits reflecting less unfavorable results from reduced levels of debt proceeds held as cash. Net charges from other corporate activities increased $56 million. The third quarter of 2012 includes a $78 million charge in the third quarter of 2012 from the impact of an annual review and update of assumptions on the reserves for certain retained obligations relating to pre-demutualization policyholders to whom we had previously agreed to provide insurance for reduced or no premium in accordance with contractual settlements related to prior individual life insurance sales practices remediation. In addition, corporate retained expenses in the third quarter of 2012 includes an increase of $73 million to our compensation liabilities, primarily due to the impact of equity markets on deferred compensation plans, $16 million of charges related to the prepayment of outstanding debt and $10 million in less favorable results from our corporate foreign exchange hedging activities. These charges are offset by the absence of a $99 million increase in reserves for estimated payments arising from use of the new Social Security Master Death file criteria to identify deceased policy and contract holders and a $20 million expense related to a voluntary contribution to be made to the insurance industry insolvency fund, related to Executive Life Insurance, both reflected in the third quarter of 2011.

Results from corporate operations pension income and employee benefits decreased $34 million primarily due to a decrease in income from our qualified pension plan and an increase in retained employee benefits costs. Income from our qualified pension plan decreased $15 million, from $73 million in the third quarter of 2011 to $58 million in the third quarter of 2012 driven by changes in the discount rate and expected rate of return on plan assets as discussed in our Annual Report on Form 10-K for the year ended December 31, 2011, under “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Results of Operations for Financial Services Businesses by Segment—Corporate and Other.”

2012 to 2011 Nine Month Comparison. The loss from Corporate and Other operations, on an adjusted operating income basis, increased $221 million, from $858 million in the first nine months of 2011 to $1,079 million in the first nine months of 2012. Capital debt interest expense increased $60 million primarily due to higher levels of capital debt. Net investment income, net of interest expense, excluding capital debt interest expense, decreased $23 million reflecting less favorable results from equity method investments and higher levels of operating debt. Net charges from other corporate activities for the first nine months of 2012 include a $78 million charge from the impact of an annual review and update of assumptions on the reserves for certain retained obligations relating to pre-demutualization policyholders to whom we had previously agreed to provide insurance for reduced or no premium in accordance with contractual settlements related to prior individual life insurance sales practices remediation and a $31 million increase in our estimate of payments arising from the use of new Social Security Death File matching criteria to identify deceased policy and contract holders. In addition, retained in corporate expenses increased the first nine months of 2012, primarily from corporate advertising, the results of our corporate foreign exchange hedging activities and the prepayment of outstanding debt. These increases are offset by the absence of a $99 million increase in reserves for estimated payments arising from use of the new Social Security Master Death file criteria to identify deceased policy and contract holders and a $20 million expense related to a voluntary contribution to be made to the insurance industry insolvency fund, related to Executive Life Insurance, both reflected in the first nine months of 2011.

Results from corporate operations pension income and employee benefits decreased $85 million primarily due to a decrease in income from our qualified pension plan and an increase in retained employee benefits costs.

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Income from our qualified pension plan decreased $44 million, from $218 million in the first nine months of 2011 to $174 million in the first nine months of 2012 driven by changes in the discount rate and expected rate of return on plan assets as discussed above.

Capital Protection Framework

Corporate and Other operations includes the results of our Capital Protection Framework, which includes among other initiatives, the capital hedge program. The capital hedge program broadly addresses the equity market exposure of the statutory capital of the Company as a whole, under stress scenarios, as described under “—Liquidity and Capital Resources—Liquidity and Capital Resources of Subsidiaries—Domestic Insurance Subsidiaries.” This hedge program resulted in charges for amortization of derivative costs of $11 million and $6 million for the three months ended September 30, 2012 and 2011, respectively, and $28 million and $14 million for the nine months ended September 30, 2012 and 2011, respectively. The market value changes of these derivatives included in “Realized investment gains (losses), net and related adjustments” were a loss of $14 million and a gain of $17 million for the three months ended September 30, 2012 and 2011, respectively. The market value changes of these derivatives were a loss of $17 million and a gain of $18 million for the nine months ended September 30, 2012 and 2011, respectively. We assess the composition of our hedging program on an ongoing basis, and we may change it from time to time based on our evaluation of our risk position or other factors.

In addition to hedging equity market exposure, we may choose to manage the interest rate risk associated with certain of our products by holding capital against a portion of the interest rate exposure rather than fully hedging the risk. “Realized investment gains (losses), net and related adjustments” includes net gains of $139 million and net losses of $1,428 million for the three months ended September 30, 2012 and 2011 respectively, and net losses of $155 million and $1,459 million for the nine month ended September 30, 2012 and 2011, respectively, resulting from our decision to utilize this strategy to manage a portion of our interest rate risk. The capital consequences associated with our decision to hold capital against a portion of our interest rate exposure have been factored into our Capital Protection Framework.

In addition, we manage certain of the risks associated with our variable annuity products through our living benefit hedging program, which is described under “—U.S. Retirement Solutions and Investment Management Division—Individual Annuities.” Through our Capital Protection Framework, we maintain access to on-balance sheet capital and contingent sources of capital that are available to meet capital needs that may arise related to this hedging program.

For more information on our Capital Protection Framework, see “—Liquidity and Capital Resources.”

Results of Operations of Closed Block Business

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

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

As of September 30, 2012, the excess of actual cumulative earnings over the expected cumulative earnings was $781 million, which was recorded as a policyholder dividend obligation. Actual cumulative earnings, as required by U.S. GAAP, reflect the recognition of realized investment gains and losses in the current period, as well as changes in assets and related liabilities that support the Closed Block policies. Additionally, the accumulation of net unrealized investment gains that have arisen subsequent to the establishment of the Closed Block have been reflected as a policyholder dividend obligation of $5,582 million at September 30, 2012, to be paid to Closed Block policyholders unless offset by future experience, with an offsetting amount reported in “Accumulated other comprehensive income (loss).”

Operating Results

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
U.S. GAAP results:				
Revenues	$ 1,504	$ 1,695	$ 4,657	$ 5,046
Benefits and expenses	1,435	1,649	4,560	4,955
Income from continuing operations before income taxes and equity in earnings of operating joint ventures	$ 69	$ 46	$ 97	$ 91

Income from Continuing Operations Before Income Taxes and Equity in Earnings of Operating Joint Ventures

2012 to 2011 Three Month Comparison. Income from continuing operations before income taxes and equity in earnings of operating joint ventures increased $23 million, from $46 million of income in the third quarter of 2011 to $69 million in the third quarter of 2012. Results for third quarter of 2012 include $166 million of lower realized investment gains, primarily driven by market value declines on derivatives used to hedge foreign denominated investments. For a discussion of Closed Block Business realized investment gains (losses), net, see “—Realized Investment Gains and Losses.” Partially offsetting this item was a $34 million lower increase in reserves for estimated payments arising from the use of new Social Security Master Death File matching criteria to identify deceased policy and contract holders. As a result of the above and other variances, a $2 million policyholder dividend obligation expense was recorded in the third quarter of 2012, compared to $160 million in the third quarter of 2011. As noted above, as of September 30, 2012, the excess of actual cumulative earnings over the expected cumulative earnings was $781 million. If actual cumulative earnings fall below expected cumulative earnings in future periods, earnings volatility in the Closed Block Business, which is primarily due to changes in investment results, may not be offset by changes in the cumulative policyholder dividend obligation.

2012 to 2011 Nine Month Comparison. Income from continuing operations before income taxes and equity in earnings of operating joint ventures increased $6 million, from $91 million in the first nine months of 2011 to $97 million in the first nine months of 2012. Results for the first nine months of 2012 include $267 million of

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lower realized investment gains, primarily due to lower trading gains on equity and fixed maturity investments, as well as unfavorable changes in the value of derivatives used to manage portfolio duration resulting from changes in interest rates. For a discussion of Closed Block Business realized investment gains (losses), net, see “—Realized Investment Gains and Losses.” Also contributing to the decline in results was a $48 million decrease in net investment income primarily due to lower reinvestment rates and a $36 million expense related to an increase in the change in reserves for estimated payments arising from the use of new Social Security Master Death File matching criteria to identify deceased policy and contract holders. As a result of the above and other variances, a $19 million policyholder dividend obligation expense was recorded in the first nine months of 2012, compared to $396 million in the first nine months of 2011.

Revenues

2012 to 2011 Three Month Comparison. Revenues, as shown in the table above under “—Operating Results,” decreased $191 million, from $1,695 million in the third quarter of 2011 to $1,504 million in the third quarter of 2012, principally driven by the $166 million decrease in net realized investment gains, as discussed above. In addition, net investment income decreased by $22 million primarily reflecting the impact of lower reinvestment rates and lower average invested assets as the business runs off.

2012 to 2011 Nine Month Comparison. Revenues decreased $389 million, from $5,046 million in the first nine months of 2011 to $4,657 million in the first nine months of 2012, principally driven by the $267 million decrease in net realized investment gains, as discussed above. Premiums declined by $70 million, with a related decrease in changes in reserves, primarily due to the expected in force decline as policies terminate. Also contributing to the decline in revenues was a $48 million decrease in net investment income, as discussed above.

Benefits and Expenses

2012 to 2011 Three Month Comparison. Benefits and expenses, as shown in the table above under “—Operating Results,” decreased $214 million, from $1,649 million in the third quarter of 2011 to $1,435 million in the third quarter of 2012. This decrease was driven by a $161 million decline in dividends to policyholders including a $158 million decrease in the policyholder dividend obligation expense reflecting a lower increase in cumulative earnings. In addition, policyholders’ benefits, including changes in reserves, decreased $52 million primarily due to a lower increase in reserves for estimated payments arising from the use of new Social Security Master Death File matching criteria to identify deceased policy and contract holders.

2012 to 2011 Nine Month Comparison. Benefits and expenses decreased $395 million, from $4,955 million in the first nine months of 2011 to $4,560 million in the first nine months of 2012. This decrease was driven by a $394 million decline in dividends to policyholders including a decrease of $377 million in the policyholder dividend obligation expense reflecting a lower increase in cumulative earnings, as well as a $17 million decline in dividends paid and accrued to policyholders driven by a decline in policies in force. These favorable items were partially offset by an increase in policyholders’ benefits, including changes in reserves, of $8 million primarily due to an increase in the change in reserves for estimated payments arising from the use of new Social Security Master Death File matching criteria to identify deceased policy and contract holders and unfavorable mortality experience, partly offset by lower expenses, in line with the decline in premiums, due to the expected in force decline as policies terminate.

Income Taxes

Our income tax provision amounted to an income tax benefit of $331 million in the third quarter of 2012 compared to an expense of $860 million in the third quarter of 2011. The decrease in income tax expense primarily reflects the decrease in pre-tax net income from continuing operations before income taxes and equity in earnings of operating joint ventures from the third quarter of 2011 to the third quarter of 2012.

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Our income tax provision amounted to an income tax expense of $572 million in the first nine months of 2012 compared to an expense of $1,312 million in the first nine months of 2011. The first nine months of 2012 and 2011 includes $343 million and $240 million, respectively, of an additional U.S. tax related to the realization of a portion of the local deferred tax assets existing on the opening day balance sheet for the Star and Edison Businesses. The increase in the additional U.S. tax is a result of the merger of Star and Edison Businesses into the Gibraltar Life Insurance Company, Ltd. It represents the recomputed U.S. tax liability on Gibraltar’s prior earnings as a result of the repatriation assumption and the merger of the entities. The local utilization of the deferred tax asset coupled with the repatriation assumption to the applicable earnings of our Japanese entities creates the effect of a “double tax” for U.S. GAAP purposes, whereas only one incidence of tax will ever be paid. In addition, income tax expense for the first nine months of 2011 includes a $42 million tax benefit from the release of a valuation allowance related to a foreign subsidiary. Excluding the impact of the “double tax” and the release of the valuation allowance, the income tax expense decreased primarily due to the decrease in pre-tax income from continuing operations before income taxes and equity in earnings of operating joint ventures from the first nine months of 2011 to the first nine months of 2012.

For additional information regarding income taxes, see Note 12 to the Unaudited Interim Consolidated Financial Statements.

Discontinued Operations

Included within net income are the results of businesses which are reflected as discontinued operations under U.S. GAAP. Income (loss) from discontinued operations, net of taxes, was $(2) million and $(9) million for the three months ended September 30, 2012 and 2011, respectively, and $12 million and $21 million for the nine months ended September 30, 2012 and 2011, respectively.

For additional information regarding discontinued operations see Note 3 to the Unaudited Interim Consolidated Financial Statements.

Divested Businesses

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Long-Term Care Business	$ (680)	$ 19	$ (662)	$ 34
Real Estate and Relocation Services Business	7	22	21	25
Individual Health Insurance	(1)	(1)	(7)	(11)
Property and Casualty	(13)	1	(10)	2
Financial Advisory	(2)	(2)	(5)	(6)
Other	4	4	6	5
Total divested businesses excluded from adjusted operating income	$ (685)	$ 43	$ (657)	$ 49

In July 2012, we announced our decision to cease sales of group long-term care insurance reflecting the challenging economics of the long-term care market including the continued low interest rate environment as well as our desire to focus our resources on our core group life and disability businesses. We discontinued sales

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of group long-term care products effective August 1, 2012, or a later date as may be required by specific state law. We notified our clients of our intent to continue to accept enrollments on existing group long-term care contracts through June 30, 2013 or later as required by contractual provisions. In March 2012, we also discontinued sales of our individual long-term care products. As a result of our decision to wind down this business, we have reflected the results of the long-term care insurance business, previously reported within the Group Insurance segment, as a divested business for all periods presented. Results for three and nine months ended September 30, 2012, as presented in the table above, include a $693 million net charge, before taxes, from adjustments to deferred policy acquisition and other costs and the reserves for our long-term care products, reflecting updates to the estimated profitability of the business, driven by updates to our morbidity assumptions and reductions to our long-term interest rate assumptions, partially offset by expected future premium increases. We have factored into our assumptions our best estimate of the timing and amount of anticipated and yet-to-be-filed premium increases which will require state approval. Our actual experience obtaining pricing increases could be materially different than what we have assumed, resulting in further policy liability increases which could be material.

Experience-Rated Contractholder Liabilities,

Trading Account Assets Supporting Insurance Liabilities and Other Related Investments

Certain products included in the Retirement and International Insurance segments are experience-rated in that investment results associated with these products are expected to ultimately accrue to contractholders. The majority of investments supporting these experience-rated products are classified as trading and are carried at fair value. These trading investments are reflected on the statements of financial position as “Trading account assets supporting insurance liabilities, at fair value” (“TAASIL”). Realized and unrealized gains and losses for these investments are reported in “Asset management fees and other income.” Interest and dividend income for these investments is reported in “Net investment income.” To a lesser extent, these experience-rated products are also supported by derivatives and commercial mortgage and other loans. The derivatives that support these experience-rated products are reflected on the statement of financial position as “Other long-term investments” and are carried at fair value, and the realized and unrealized gains and losses are reported in “Realized investment gains (losses), net.” The commercial mortgage and other loans that support these experience-rated products are carried at unpaid principal, net of unamortized discounts and an allowance for losses, and are reflected on the statements of financial position as “Commercial mortgage and other loans.” Gains and losses on sales and changes in the valuation allowance for commercial mortgage and other loans are reported in “Realized investment gains (losses), net.”

Our Retirement segment has two types of experience-rated products that are supported by TAASIL and other related investments. Fully participating products are those for which the entire return on underlying investments is passed back to the policyholders through a corresponding adjustment to the related liability. The adjustment to the liability is based on changes in the fair value of all of the related assets, including commercial mortgage and other loans, which are carried at amortized cost, less any valuation allowance. Partially participating products are those for which only a portion of the return on underlying investments is passed back to the policyholders over time through changes to the contractual crediting rates. The crediting rates are typically reset semiannually, often subject to a minimum crediting rate, and returns are required to be passed back within ten years.

In our International Insurance segment, the experience-rated products are fully participating. As a result, the entire return on the underlying investments is passed back to policyholders through a corresponding adjustment to the related liability.

Adjusted operating income excludes net investment gains and losses on TAASIL, related derivatives and commercial mortgage and other loans. This is consistent with the exclusion of realized investment gains and losses with respect to other investments supporting insurance liabilities managed on a consistent basis. In addition, to be consistent with the historical treatment of charges related to realized investment gains and losses

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on investments, adjusted operating income also excludes the change in contractholder liabilities due to asset value changes in the pool of investments (including changes in the fair value of commercial mortgage and other loans) supporting these experience-rated contracts, which are reflected in “Interest credited to policyholders’ account balances.” The result of this approach is that adjusted operating income for these products includes net fee revenue and interest spread we earn on these experience-rated contracts, and excludes changes in fair value of the pool of investments, both realized and unrealized, that we expect will ultimately accrue to the contractholders.

The following tables set forth the impact of these items on results that are excluded from adjusted operating income for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Retirement Segment:				
Investment gains (losses) on:				
Trading account assets supporting insurance liabilities, net	$ 268	$ 119	$ 436	$ 306
Derivatives	(25)	(102)	(66)	(135)
Commercial mortgages and other loans	(2)	6	(3)	13
Change in experience-rated contractholder liabilities due to asset value changes(1)(2)	(258)	(41)	(380)	(212)
Net gains (losses)	$ (17)	$ (18)	$ (13)	$ (28)
International Insurance Segment:				
Investment gains (losses) on trading account assets supporting insurance liabilities, net	$ (4)	$ (109)	$ 66	$ (136)
Change in experience-rated contractholder liabilities due to asset value changes	4	109	(66)	136
Net gains (losses)	$ 0	$ 0	$ 0	$ 0
Total:				
Investment gains (losses) on:				
Trading account assets supporting insurance liabilities, net	$ 264	$ 10	$ 502	$ 170
Derivatives	(25)	(102)	(66)	(135)
Commercial mortgages and other loans	(2)	6	(3)	13
Change in experience-rated contractholder liabilities due to asset value changes(1)(2)	(254)	68	(446)	(76)
Net gains (losses)	$ (17)	$ (18)	$ (13)	$ (28)

(1) Decreases to contractholder liabilities due to asset value changes are limited by certain floors and therefore do not reflect cumulative declines in recorded asset values of $4 million and $8 million as of September 30, 2012 and 2011, respectively. We have recovered and expect to recover in future periods these declines in recorded asset values through subsequent increases in recorded asset values or reductions in crediting rates on contractholder liabilities.

(2) Included in the amounts above related to the change in the liability to contractholders as a result of commercial mortgage and other loans are increases of $19 million and $17 million for the three months ended September 30, 2012 and 2011, respectively, and increases of $19 million and $31 million for the nine months ended September 30, 2012 and 2011, respectively. As prescribed by U.S. GAAP, changes in the fair value of commercial mortgage and other loans held for investment in our general account, other than when associated with impairments, are not recognized in income in the current period, while the impact of these changes in fair value are reflected as a change in the liability to fully participating contractholders in the current period.

As shown in the table above, the net impacts for the Retirement segment of changes in experience-rated contractholder liabilities and investment gains and losses on trading account assets supporting insurance liabilities and other related investments were net losses of $17 million and $18 million for the three months

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ended September 30, 2012 and 2011, respectively, and net losses of $13 million and $28 million for the nine months ended September 30, 2012 and 2011, respectively. These impacts primarily reflect timing differences between the recognition of the mark-to-market adjustments and the recognition of the recovery of these adjustments in future periods through subsequent increases in asset values or reductions in crediting rates on contractholder liabilities for partially participating products. These impacts also reflect the difference between the fair value of the underlying commercial mortgage and other loans and the amortized cost, less any valuation allowance, of these loans, as described above.

As shown in the table above, the International Insurance segment includes offsetting impacts, in all periods, from changes in investment gains and losses on trading account assets supporting insurance liabilities and experience-rated contractholder liabilities.

Valuation of Assets and Liabilities

Fair Value of Assets and Liabilities

The authoritative guidance related to fair value measurement establishes a framework that includes a three-level hierarchy used to classify the inputs used in measuring fair value. The level in the hierarchy within which the fair value falls is determined based on the lowest level input that is significant to the measurement. The fair values of assets and liabilities classified as Level 3 include at least one or more significant unobservable input in the measurement. See Note 13 to the Unaudited Interim Consolidated Financial Statements for an additional description of the valuation hierarchy levels.

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The tables below present the balances of assets and liabilities measured at fair value on a recurring basis, as of the periods indicated, split between the Financial Services Businesses and Closed Block Business, and the portion of such assets and liabilities that are classified in Level 3 of the valuation hierarchy. See Note 13 to the Unaudited Interim Consolidated Financial Statements for the balances of assets and liabilities measured at fair value on a recurring basis by hierarchy level presented on a consolidated basis.

	As of September 30, 2012				As of December 31, 2011			
	Financial Services Businesses		Closed Block Business		Financial Services Businesses		Closed Block Business	
	Total at Fair Value	Total Level 3(1)	Total at Fair Value	Total Level 3(1)	Total at Fair Value	Total Level 3(1)	Total at Fair Value	Total Level 3(1)
	(in millions)							
Fixed maturities, available-for-sale	$ 226,015	$ 3,958	$ 47,366	$ 1,180	$ 208,132	$ 3,098	$ 46,516	$ 1,132
Trading account assets supporting insurance liabilities:								
Fixed maturities	18,489	535	0	0	17,619	498	0	0
Equity securities	1,003	19	0	0	911	20	0	0
Short-term investments and cash equivalents	640	0	0	0	951	0	0	0
Subtotal	20,132	554	0	0	19,481	518	0	0
Other trading account assets:								
Fixed maturities	1,017	102	136	0	1,302	114	189	0
Equity securities	1,429	1,135	128	114	1,493	1,153	128	123
All other(2)	3,164	32	0	0	2,433	93	0	0
Subtotal	5,610	1,269	264	114	5,228	1,360	317	123
Equity securities, available-for-sale	4,821	334	3,171	12	4,413	333	3,122	27
Commercial mortgage and other loans	248	68	0	0	600	86	0	0
Other long-term investments	1,675	1,014	(100)	0	1,107	1,110	185	0
Short-term investments	7,774	0	1,470	0	8,232	0	528	0
Cash equivalents	8,575	0	792	0	8,392	0	1,037	0
Other assets	75	8	110	0	(13)	9	111	0
Subtotal excluding separate account assets	274,925	7,205	53,073	1,306	255,572	6,514	51,816	1,282
Separate account assets	247,510	20,339	0	0	218,380	19,358	0	0
Total assets	$ 522,435	$ 27,544	$ 53,073	$ 1,306	$ 473,952	$ 25,872	$ 51,816	$ 1,282
Future policy benefits	$ 3,638	$ 3,638	$ 0	$ 0	$ 2,886	$ 2,886	$ 0	$ 0
Other liabilities(2)	565	395	0	0	444	285	0	0
Total liabilities	$ 4,203	$ 4,033	$ 0	$ 0	$ 3,330	$ 3,171	$ 0	$ 0

(1) The amount of Level 3 assets taken as a percentage of total assets measured at fair value on a recurring basis totaled 5.3% and 5.5% as of September 30, 2012 and December 31, 2011, respectively, for the Financial Services Businesses, and 2.5% as of both September 30, 2012 and December 31, 2011, respectively, for the Closed Block Business. The amount of Level 3 liabilities was immaterial to our balance sheet.

(2) “All other” and “Other liabilities” primarily include derivatives. The amounts classified as Level 3 for the Financial Services Businesses exclude the impact of netting.

The determination of fair value, which for certain assets and liabilities is dependent on the application of estimates and assumptions, can have a significant impact on our results of operations and may require the application of a greater degree of judgment depending on market conditions, as the ability to value assets and

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liabilities can be significantly impacted by a decrease in market activity or a lack of transactions executed in an orderly manner. The following sections provide information regarding certain assets and liabilities of our Financial Services Businesses and our Closed Block Business which are valued using Level 3 inputs and could have a significant impact on our results of operations.

Fixed Maturity and Equity Securities

Fixed maturity securities included in Level 3 in our fair value hierarchy are generally priced based on internally-developed valuations or indicative broker quotes. For certain private fixed maturity and equity securities, the discounted cash flow or other valuation model uses significant unobservable inputs and, accordingly, such securities are included in Level 3 in our fair value hierarchy. Level 3 fixed maturity securities included approximately $4.1 billion as of September 30, 2012 and $3.2 billion as of December 31, 2011 of public fixed maturities, with values primarily based on indicative broker quotes, and approximately $1.7 billion as of September 30, 2012 and $1.6 billion as of December 31, 2011 of private fixed maturities, with values primarily based on internally-developed models. Significant unobservable inputs used included: issue specific credit adjustments, material non-public financial information, management judgment, estimation of future earnings and cash flows, default rate assumptions, liquidity assumptions and indicative quotes from market makers. These inputs are usually considered unobservable, as not all market participants will have access to this data.

The impact our determination of fair value for fixed maturity and equity securities has on our results of operations is dependent on our classification of the security as either trading, available-for-sale, or held-to-maturity. For our investments classified as trading, the impact of changes in fair value is recorded within “Asset management fees and other income.” For our investments classified as available-for-sale, the impact of changes in fair value is recorded as an unrealized gain or loss in “Accumulated other comprehensive income (loss),” a separate component of equity. Our investments classified as held-to-maturity are carried at amortized cost.

Other Long-Term Investments

Other long-term investments classified in Level 3 primarily include real estate held in consolidated investment funds and fund investments where the fair value option has been elected. The fair value of real estate held in consolidated investment funds is determined through an independent appraisal process. The appraisals generally utilize a discounted cash flow model. The appraisals also include replacement cost estimates and recent sales data as alternate methods of fair value. These appraisals and the related assumptions are updated at least annually. Since many of the assumptions utilized are unobservable and are considered to be significant inputs to the valuation, the real estate investments within other long-term investments are reflected within Level 3. Consolidated real estate investment funds classified as Level 3 totaled approximately $0.5 billion and $0.4 billion as of September 30, 2012 and December 31, 2011, respectively. The fair value of fund investments, where the fair value option has been elected, is primarily determined by the fund managers. Since the valuations may be based on unobservable market inputs and cannot be validated by the Company, these investments are included within Level 3. Investments in these funds included in Level 3 totaled approximately $0.5 billion and $0.4 billion as of September 30, 2012 and December 31, 2011, respectively.

Derivative Instruments

Derivatives classified as Level 3, excluding embedded derivatives which are discussed in “—Variable Annuity Optional Living Benefit Features” below, include first-to-default credit basket swaps, look-back equity options and other structured products. These derivatives are recorded at fair value either as assets, within “Other trading account assets,” or “Other long-term investments,” or as liabilities, within “Other liabilities,” and are valued based upon models with some significant unobservable market inputs or inputs from less actively traded markets. We validate these values through periodic comparison of our fair values to broker-dealer values. The fair values of OTC derivative assets and liabilities classified as Level 3 totaled approximately $26 million and $1 million, respectively, as of September 30, 2012 and $84 million and $3 million, respectively, as of December 31, 2011, without giving consideration to the impact of netting.

All realized and unrealized changes in fair value of these derivatives, with the exception of the effective portion of qualifying cash flow hedges and hedges of net investments in foreign operations, are recorded in current earnings. Generally, the changes in fair value of these derivatives, excluding those that qualify for hedge accounting, are recorded in “Realized investment gains (losses), net.” For additional information regarding the impact of changes in fair value of derivative instruments on our results of operations see “—Realized Investment Gains and Losses” below.

Separate Account Assets

Separate account assets included in Level 3 primarily include real estate investments for which values are determined consistent with similar instruments described above under “Other Long-Term Investments.” Separate account liabilities are reported at contract value and not fair value.

Variable Annuity Optional Living Benefit Features

Future policy benefits classified in Level 3 primarily include liabilities related to guarantees associated with the optional living benefit features of certain variable annuity contracts offered by our Individual Annuities segment, including guaranteed minimum accumulation benefits (“GMAB”), guaranteed minimum withdrawal benefits (“GMWB”) and guaranteed minimum income and withdrawal benefits (“GMIWB”). These benefits are accounted for as embedded derivatives and carried at fair value with changes in fair value included in “Realized investment gains (losses), net.” The fair values of the GMAB, GMWB and GMIWB liabilities are calculated as the present value of future expected benefit payments to customers less the present value of assessed rider fees attributable to the embedded derivative feature. This methodology could result in either a liability or contra-liability balance, given changing capital market conditions and various policyholder behavior assumptions. Since there is no observable active market for the transfer of these obligations, the valuations are calculated using internally-developed models with option pricing techniques. These models utilize significant assumptions that are primarily unobservable, including assumptions as to lapse rates, NPR, utilization rates, withdrawal rates, mortality rates and equity market volatility. As a result, the liability included in future policy benefits is reflected within Level 3 in our fair value hierarchy. Future policy benefits classified as Level 3 were net liabilities of $3,638 million and $2,886 million as of September 30, 2012 and December 31, 2011, respectively. The change was driven by changes in the fair values of our GMAB, GMWB and GMIWB liabilities, primarily reflecting declines in interest rates and tightening of our NPR credit spreads, partially offset by the impact of equity market appreciation. For additional information see “—Results of Operations for Financial Services Businesses by Segment—U.S. Retirement Solutions and Investment Management Division—Individual Annuities.”

For additional information about the key estimates and assumptions used in our determination of fair value, see Note 13 to the Unaudited Interim Consolidated Financial Statements.

Realized Investment Gains and Losses

Realized investment gains and losses are generated from numerous sources, including the sale of fixed maturity securities, equity securities, investments in joint ventures and limited partnerships and other types of investments, as well as adjustments to the cost basis of investments for other-than-temporary impairments. Realized investment gains and losses are also generated from prepayment premiums received on private fixed maturity securities, net changes in the allowance for losses, as well as gains and losses on sales, certain restructurings and foreclosures on commercial mortgage and other loans and fair value changes on commercial mortgage loans carried at fair value. In addition, realized investment gains and losses are generated by fair value changes on embedded derivatives and free-standing derivatives that do not qualify for hedge accounting treatment (except those derivatives used in our capacity as a broker or dealer), including those related to certain optional living benefit guarantees and related hedge positions in our Individual Annuities segment. See “—Results of Operations for Financial Services Businesses by Segment—U.S. Retirement Solutions and Investment Management Division—Individual Annuities.”

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For a further discussion of our policies regarding other-than-temporary declines in investment value and the related methodology for recording fixed maturity other-than-temporary impairments, see “—General Account Investments—Fixed Maturity Securities—Other-Than-Temporary Impairments of Fixed Maturity Securities” below. For a further discussion of our policies regarding other-than-temporary declines in investment value and the related methodology for recording equity impairments, see “—General Account Investments—Equity Securities—Other-than-Temporary Impairments of Equity Securities” below. For a further discussion of our policy regarding commercial mortgage and other loans, see “—General Account Investments—Commercial Mortgage and Other Loans—Commercial Mortgage and Other Loan Quality” below.

The level of other-than-temporary impairments generally reflects economic conditions and is expected to increase when economic conditions worsen and to decrease when economic conditions improve. Historically, the causes of other-than-temporary impairments have been specific to each individual issuer and have not directly resulted in impairments to other securities within the same industry or geographic region. As discussed in more detail below, certain of the other-than-temporary impairments recognized for the three months and nine months ended September 30, 2012 primarily relate to losses from foreign currency exchange rate movements on securities that are approaching maturity, as well as asset-backed securities collateralized by sub-prime mortgages, reflecting adverse financial conditions of the respective issuers. Other-than-temporary impairments recognized for the three months and nine months ended September 30, 2011 primarily relate to losses from foreign currency exchange rate movements on securities that are approaching maturity, as well as asset-backed securities collateralized by sub-prime mortgages and Japanese commercial mortgage-backed securities, reflecting adverse financial conditions of the respective issuers.

We may realize additional credit and interest rate related losses through sales of investments pursuant to our credit risk and portfolio management objectives. Other-than-temporary impairments, interest rate related losses and credit related losses on sales (other than those related to certain of our businesses which primarily originate investments for sale or syndication to unrelated investors) are excluded from adjusted operating income.

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

We use interest rate and currency swaps and other derivatives to manage interest and currency exchange rate exposures arising from mismatches between assets and liabilities, including duration mismatches. We use derivative contracts to mitigate the risk that unfavorable changes in currency exchange rates will reduce U.S. dollar equivalent earnings generated by certain of our non-U.S. businesses. We also use equity-based and interest rate derivatives to hedge the risks embedded in some of our annuity products. Derivative contracts also include forward purchases and sales of to-be-announced mortgage-backed securities primarily related to our dollar roll program. Many of these derivative contracts do not qualify for hedge accounting, and consequently, we recognize the changes in fair value of such contracts from period to period in current earnings, although we do not necessarily account for the related assets or liabilities the same way. Accordingly, realized investment gains and losses from our derivative activities can contribute significantly to fluctuations in net income.

Adjusted operating income generally excludes “Realized investment gains (losses), net,” subject to certain exceptions (realized investment gains or losses within certain of our businesses for which such gains or losses are a principal source of earnings and those associated with terminating hedges of foreign currency earnings and current period yield adjustments), and related charges and adjustments.

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The following tables set forth “Realized investment gains (losses), net,” by investment type for the Financial Services Businesses and Closed Block Business, as well as related charges and adjustments associated with the Financial Services Businesses, for the periods indicated. For additional details regarding adjusted operating income, which is our measure of performance for the segments of our Financial Services Businesses, see Note 11 to the Unaudited Interim Consolidated Financial Statements.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Realized investment gains (losses), net:				
Financial Services Businesses	$ (1,519)	$ 2,288	$ (1,284)	$ 2,461
Closed Block Business	74	240	218	485
Consolidated realized investment gains (losses), net	$ (1,445)	$ 2,528	$ (1,066)	$ 2,946
Financial Services Businesses:				
Realized investment gains (losses), net:				
Fixed maturity securities	$ (85)	$ (50)	$ (194)	$ (87)
Equity securities	10	(82)	(59)	(98)
Commercial mortgage and other loans	23	39	45	65
Derivative instruments	(1,467)	2,398	(1,012)	2,533
Other	0	(17)	(64)	48
Total	$ (1,519)	$ 2,288	$ (1,284)	$ 2,461
Related adjustments	(432)	1,097	(325)	714
Realized investment gains (losses), net, and related adjustments	(1,951)	3,385	(1,609)	3,175
Related charges	648	(1,568)	498	(1,732)
Realized investment gains (losses), net, and related charges and adjustments	$ (1,303)	$ 1,817	$ (1,111)	$ 1,443
Closed Block Business:				
Realized investment gains (losses), net:				
Fixed maturity securities	$ 32	$ 48	$ 46	$ 89
Equity securities	30	28	62	224
Commercial mortgage and other loans	5	7	4	15
Derivative instruments	9	159	109	160
Other	(2)	(2)	(3)	(3)
Total	$ 74	$ 240	$ 218	$ 485

2012 to 2011 Three Month Comparison

Financial Services Businesses

The Financial Services Businesses’ net realized investment losses in the third quarter of 2012 were $1,519 million, compared to net realized investment gains of $2,288 million in the third quarter of 2011.

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Net realized losses on fixed maturity securities were $85 million in the third quarter of 2012, compared to net realized losses of $50 million in the third quarter of 2011, as set forth in the following table:

	Three Months Ended September 30, 2012	2011
	(in millions)	
Realized investment gains (losses), net—Fixed Maturity Securities—Financial Services Businesses		
Gross realized investment gains:		
Gross gains on sales and maturities(1)	$ 65	$ 97
Private bond prepayment premiums	6	7
Total gross realized investment gains	71	104
Gross realized investment losses:		
Net other-than-temporary impairments recognized in earnings(2)	(82)	(101)
Gross losses on sales and maturities(1)	(72)	(53)
Credit related losses on sales	(2)	0
Total gross realized investment losses	(156)	(154)
Realized investment gains (losses), net—Fixed Maturity Securities	$ (85)	$ (50)
Net gains (losses) on sales and maturities—Fixed Maturity Securities(1)	$ (7)	$ 44

(1) Amounts exclude prepayment premiums, other-than-temporary impairments, and credit related losses through sales of investments pursuant to our credit risk objectives.
(2) Excludes the portion of other-than-temporary impairments recorded in “Other comprehensive income (loss),” 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.

Net losses on sales and maturities of fixed maturity securities were $7 million in the third quarter of 2012 and were primarily due to sales within our International Insurance segment. Net trading gains on sales and maturities of fixed maturity securities were $44 million in the third quarter of 2011 and were primarily due to sales within our Retirement and Individual Annuities segments. Sales of fixed maturity securities in our Individual Annuities segment in 2011 were primarily due to transfers of investments out of our general account and into separate accounts relating to an automatic rebalancing element embedded in the living benefit features of some of our variable annuity products. See below for additional information regarding the other-than-temporary impairments of fixed maturity securities in the third quarter of 2012 and 2011.

Net realized gains on equity securities were $10 million in the third quarter of 2012 which included net trading gains on sales of equity securities of $31 million, primarily due to sales within our Corporate and Other operations, partially offset by other-than-temporary impairments of $21 million. Net realized losses on equity securities were $82 million in the third quarter of 2011, which included net trading losses on sales of equity securities of $42 million, primarily due to sales within our International Insurance business and other-than-temporary impairments of $40 million. See below for additional information regarding the other-than-temporary impairments of equity securities in the third quarter of 2012 and 2011.

Net realized gains on commercial mortgage and other loans in the third quarter of 2012 were $23 million, primarily related to a net decrease in the loan loss reserve of $25 million and higher servicing revenue within our commercial mortgage operations, which was partially offset by realized losses on restructurings and sales of loans held within our Retirement segment. Net realized gains on commercial mortgage and other loans in the third quarter of 2011 were $39 million, primarily related to a net decrease in the loan loss reserve of $42 million and mark-to-market gains on our interim loan portfolio within our commercial mortgage operations, which was partially offset by realized losses from foreclosures and payoffs. For additional information regarding our commercial mortgage and other loan loss reserves see “—General Account Investments—Commercial Mortgage and Other Loans—Commercial Mortgage and Other Loan Quality.”

Net realized losses on derivatives were $1,467 million in the third quarter of 2012, compared to net realized gains of $2,398 million in the third quarter of 2011. The net derivative losses in the third quarter of 2012 primarily reflect net losses of $1,360 million on product related embedded derivatives and related hedge positions primarily associated with certain variable annuity contracts. Also contributing to these losses were net losses of $82 million on foreign currency forward contracts used to hedge the future income of non-U.S. businesses primarily in Japan due to the weakening of the U.S. dollar against the Japanese yen. The net derivative gains in the third quarter of 2011 primarily reflect net gains of $1,624 million on embedded derivatives and related hedge positions primarily associated with certain variable annuity contracts. Also, contributing to the net derivative gains were net mark-to-market gains of $441 million on interest rate derivatives used to manage duration as interest rates declined, net gains of $262 million on foreign currency forward contracts used in our Star and Edison Businesses to hedge portfolio assets primarily due to the strengthening of the Japanese yen against the U.S. dollar and Australian dollar, and net derivative gains of $73 million on foreign currency derivatives used primarily in our Retirement segment to hedge portfolio assets denominated mainly in Euros and Canadian dollars, as the U.S. dollar strengthened against those currencies. These gains were offset by net losses of $93 million on foreign currency forward contracts used to hedge the future income of non-U.S. businesses primarily in Japan due to the weakening of the U.S. dollar against the Japanese yen. See “—Results of Operations for Financial Services Businesses by Segment—U.S. Retirement Solutions and Investment Management Division—Individual Annuities” for additional information regarding the product related embedded derivatives and related hedge positions associated with certain variable annuity contracts.

Net realized losses on other investments were less than $1 million in the third quarter of 2012. Net realized losses on other investments were $17 million in the third quarter of 2011, which included other-than-temporary impairments of $6 million on real estate and joint ventures and partnerships investments and net trading losses of $11 million primarily from the sale of a joint venture and partnership investment within our International Insurance business.

Related adjustments include that portion of “Realized investment gains (losses), net” that are included in adjusted operating income and that portion of “Asset management fees and other income” and “Net investment income” that are excluded from adjusted operating income. The adjustments are made to arrive at “Realized investment gains (losses), net, and related adjustments” which are excluded from adjusted operating income. Related adjustments to realized investment gains (losses) were a net negative adjustment of $432 million in the third quarter of 2012. Adjustments for that portion of “Realized investment gains (losses), net” that are included in adjusted operating income were a net negative adjustment of $103 million, primarily driven by net gains from settlements on interest rate swaps, and gains that represent a principal source of earnings for certain of our businesses. Adjustments for that portion of “Asset management fees and other income” and “Net investment income” that are excluded from adjusted operating income were a net negative adjustment of $329 million, primarily driven by the impact of changes in foreign currency exchange rates on certain assets and liabilities for which we economically hedge the foreign currency exposure.

Related adjustments to realized investment gains (losses) were a net positive adjustment of $1,097 million in the third quarter of 2011. Adjustments for that portion of “Realized investment gains (losses), net” that are included in adjusted operating income were a net negative adjustment of $66 million for the third quarter 2011, primarily driven by net gains from settlements on interest rate swaps, and gains that represent a principal source of earnings for certain of our businesses, partially offset by losses related to the settlements of swaps used to hedge foreign-denominated earnings. Adjustments for that portion of “Asset management fees and other income” and “Net investment income” that are excluded from adjusted operating income were a net positive adjustment of $1,163 million, primarily driven by the impact of changes in foreign currency exchange rates on certain assets and liabilities for which we economically hedge the foreign currency exposure.

Charges that relate to “Realized investment gains (losses), net” are also excluded from adjusted operating income. Related charges were a net positive adjustment of $648 million and a net negative adjustment of $1,568 million for the third quarter of 2012 and 2011, respectively. These adjustments were primarily driven by that

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portion of amortization of deferred policy acquisition and other costs relating to net losses and net gains for the third quarter of 2012 and 2011, respectively, on embedded derivatives and related hedge positions associated with certain variable annuity contracts.

During the third quarter of 2012, we recorded other-than-temporary impairments of $103 million in earnings, compared to other-than-temporary impairments of $147 million recorded in earnings in the third quarter of 2011. The following tables set forth, for the periods indicated, the composition of other-than-temporary impairments recorded in earnings attributable to the Financial Services Businesses by asset type, and for fixed maturity securities, by reason.

	Three Months Ended September 30, 2012 (in millions)	Three Months Ended September 30, 2011 (in millions)
Other-than-temporary impairments recorded in earnings—Financial Services Businesses(1)		
Public fixed maturity securities	$ 73	$ 92
Private fixed maturity securities	9	9
Total fixed maturity securities	82	101
Equity securities	21	40
Other invested assets(2)	0	6
Total	$ 103	$ 147

(1) Excludes the portion of other-than-temporary impairments recorded in “Other comprehensive income (loss),” 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.
(2) Includes other-than-temporary impairments relating to investments in joint ventures and partnerships and real estate investments.

	Three Months Ended September 30, 2012		
	Asset-Backed Securities Collateralized By Sub-Prime Mortgages	All Other Fixed Maturity Securities	Total Fixed Maturity Securities
		(in millions)	
Other-than-temporary impairments on fixed maturity securities recorded in earnings—Financial Services Businesses(1)			
Due to credit events or adverse conditions of the respective issuer(2)	$ 13	$ 15	$ 28
Due to other accounting guidelines(3)	0	54	54
Total	$ 13	$ 69	$ 82

	Three Months Ended September 30, 2011		
	Asset-Backed Securities Collateralized By Sub-Prime Mortgages	All Other Fixed Maturity Securities	Total Fixed Maturity Securities
		(in millions)	
Other-than-temporary impairments on fixed maturity securities recorded in earnings—Financial Services Businesses(1)			
Due to credit events or adverse conditions of the respective issuer(2)	$ 22	$ 8	$ 30
Due to other accounting guidelines(3)	2	69	71

Total	$ 24	$ 77	$ 101

(1) Excludes the portion of other-than-temporary impairment recorded in “Other comprehensive income (loss),” 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.

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(2) Represents circumstances where we believe credit events or other adverse conditions of the respective issuers have caused, or will lead to, a deficiency in the contractual cash flows related to the investment. The amount of the impairment recorded in earnings is the difference between the amortized cost of the debt security and the net present value of its projected future cash flows discounted at the effective interest rate implicit in the debt security prior to impairment.
(3) Primarily represents circumstances where securities with losses from foreign currency exchange rate movements approach maturity.

Fixed maturity other-than-temporary impairments in the third quarter of 2012 were concentrated in the finance, capital goods, consumer non-cyclical, and technology sectors of our corporate securities, and asset-backed securities collateralized by sub-prime mortgages. These other-than-temporary impairments were primarily related to securities with unrealized losses from foreign currency exchange rate movements that are approaching maturity or related to securities with liquidity concerns, downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers, which have caused, or we believe will lead to, a deficiency in the contractual cash flows related to the investment. During the third quarter of 2012, we recorded other-than-temporary impairments of $51 million in earnings related to securities with unrealized losses from foreign currency exchange rate movements that are approaching maturity. Our Japanese insurance operations hold non-yen denominated investments which in some cases, due primarily to the strengthening of the yen against the U.S. dollar, are currently in an unrealized loss position. As the securities approach maturity and remain in an unrealized loss position, it becomes less likely that the exchange rates will recover and more likely that losses will be realized upon maturity. Accordingly, additional impairments are to be recorded in earnings as they approach maturity. As of September 30, 2012, gross unrealized losses related to those securities maturing between October 1, 2012 and December 31, 2014 are $357 million. Absent a change in currency rates, impairments of approximately $23 million would be recorded in earnings over the remaining three months of 2012 and approximately $123 million in 2013 on these securities. Fixed maturity other-than-temporary impairments in the third quarter of 2011 were concentrated in the consumer non-cyclical, utility, and finance sectors of our corporate securities, and asset-backed securities collateralized by sub-prime mortgages. These other-than-temporary impairments were primarily related to securities with unrealized foreign currency translation losses that are approaching maturity or related to securities with liquidity concerns, downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers, which have caused, or we believe will lead to, a deficiency in the contractual cash flows related to the investment.

Equity security other-than-temporary impairments in the third quarter of both 2012 and 2011 were primarily driven by circumstances where the decline in value was maintained for one year or greater or where we intend to sell the security.

Other invested assets other-than-temporary impairments in the third quarter of both 2012 and 2011 were mainly driven by a decline in value on certain real estate and joint ventures and partnerships investments.

Closed Block Business

For the Closed Block Business, net realized investment gains in the third quarter of 2012 were $74 million, compared to net realized investment gains of $240 million in the third quarter of 2011.

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Net realized gains on fixed maturity securities were $32 million in the third quarter of 2012, compared to net realized gains of $48 million in the third quarter of 2011, as set forth in the following table:

	Three Months Ended September 30,	
	2012	2011
	(in millions)	
Realized investment gains (losses), net—Fixed Maturity Securities—Closed Block Business		
Gross realized investment gains:		
Gross gains on sales and maturities(1)	$ 50	$ 77
Private bond prepayment premiums	8	7
Total gross realized investment gains	58	84
Gross realized investment losses:		
Net other-than-temporary impairments recognized in earnings(2)	(13)	(15)
Gross losses on sales and maturities(1)	(13)	(20)
Credit related losses on sales	0	(1)
Total gross realized investment losses	(26)	(36)
Realized investment gains (losses), net—Fixed Maturity Securities	$ 32	$ 48
Net gains (losses) on sales and maturities—Fixed Maturity Securities(1)	$ 37	$ 57

(1) Amounts exclude prepayment premiums, other-than-temporary impairments, and credit related losses through sales of investments pursuant to our credit risk objectives.
(2) Excludes the portion of other-than-temporary impairments recorded in “Other comprehensive income (loss),” 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.

Net trading gains on sales and maturities of fixed maturity securities were $37 and $57 million in the third quarter of 2012 and 2011, respectively. See below for additional information regarding the other-than-temporary impairments of fixed maturity securities in the third quarter of 2012 and 2011.

Net realized gains on equity securities were $30 million in the third quarter of 2012 which included net trading gains on sales of equity securities of $33 million, partially offset by other-than-temporary impairments of $3 million. Net realized gains on equity securities were $28 million in the third quarter of 2011, which included net trading gains on sales of equity securities of $30 million, partially offset by other-than-temporary impairments of $2 million. See below for additional information regarding the other-than-temporary impairments of equity securities in the third quarter of 2012 and 2011.

Net realized gains on commercial mortgage and other loans in the third quarter of 2012 of $5 million primarily related to a net decrease in the loan loss reserve. Net realized gains on commercial mortgage and other loans in the third quarter of 2011 of $7 million primarily related to a net decrease in the loan loss reserve. For additional information regarding our loan loss reserves, see “—General Account Investments—Commercial Mortgage and Other Loans—Commercial Mortgage and Other Loan Quality.”

Net realized gains on derivatives were $9 million in the third quarter of 2012, compared to net realized gains of $159 million in the third quarter of 2011. Derivative gains in the third quarter of 2012 primarily reflect net mark-to-market gains of $23 million on interest rate derivatives primarily used to manage duration as short term interest rates decreased and net gains of $15 million on “to be announced” (“TBA”) forward contracts. Partially offsetting these gains were net losses of $25 million related to currency derivatives used to hedge foreign denominated investments as the U.S. dollar weakened against the euro. The net derivative gains in the third quarter of 2011 primarily reflect net gains of $118 million on currency derivatives used to hedge foreign denominated investments as the U.S. dollar strengthened against the euro. Also, contributing to these gains are net derivative gains of $29 million on “TBA” forward contracts, and $17 million on interest rate derivatives used to manage duration as interest rates declined.

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During the third quarter of 2012, we recorded other-than-temporary impairments of $18 million in earnings, compared to other-than-temporary impairments of $19 million recorded in earnings in the third quarter of 2011. The following tables set forth, for the periods indicated, the composition of other-than-temporary impairments recorded in earnings attributable to the Closed Block Business by asset type, and for fixed maturity securities, by reason.

	Three Months Ended September 30, 2012	2011
	(in millions)	
Other-than-temporary impairments recorded in earnings—Closed Block Business(1)		
Public fixed maturity securities	$ 8	$ 15
Private fixed maturity securities	5	0
Total fixed maturity securities	13	15
Equity securities	3	2
Other invested assets(2)	2	2
Total	$ 18	$ 19

(1) Excludes the portion of other-than-temporary impairments recorded in “Other comprehensive income (loss),” 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.
(2) Includes other-than-temporary impairments relating to investments in joint ventures and partnerships.

	Three Months Ended September 30, 2012 Asset-Backed Securities Collateralized By Sub-Prime Mortgages	All Other Fixed Maturity Securities	Total Fixed Maturity Securities
		(in millions)	
Other-than-temporary impairments on fixed maturity securities recorded in earnings—Closed Block Business(1)			
Due to credit events or adverse conditions of the respective issuer(2)	$ 7	$ 6	$ 13
Due to other accounting guidelines	0	0	0
Total	$ 7	$ 6	$ 13

	Three Months Ended September 30, 2011 Asset-Backed Securities Collateralized By Sub-Prime Mortgages	All Other Fixed Maturity Securities	Total Fixed Maturity Securities
		(in millions)	
Other-than-temporary impairments on fixed maturity securities recorded in earnings—Closed Block Business(1)			
Due to credit events or adverse conditions of the respective issuer(2)	$ 6	$ 6	$ 12
Due to other accounting guidelines	3	0	3
Total	$ 9	$ 6	$ 15

(1) Excludes the portion of other-than-temporary impairment recorded in “Other comprehensive income (loss),” 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.
(2) Represents circumstances where we believe credit events or other adverse conditions of the respective issuers have caused, or will lead to, a deficiency in the contractual cash flows related to the investment. The amount of the impairment recorded in earnings is the difference between the amortized cost of the debt security and the net present value of its projected future cash flows discounted at the effective interest rate implicit in the debt security prior to impairment.

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Fixed maturity other-than-temporary impairments in the third quarter of 2012 and 2011 were concentrated in asset-backed securities collateralized by sub-prime mortgages and were primarily driven by liquidity concerns, downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers, which have caused, or we believe will lead to, a deficiency in the contractual cash flows related to the investment.

Equity security other-than-temporary impairments in the third quarter of 2012 and 2011 were primarily due to circumstances where the decline in value was maintained for one year or greater.

2012 to 2011 Nine Month Comparison

Financial Services Businesses

The Financial Services Businesses’ net realized investment losses in the first nine months of 2012 were $1,284 million, compared to net realized investment gains of $2,461 million in the first nine months of 2011.

Net realized losses on fixed maturity securities were $194 million in the first nine months of 2012, compared to net realized losses of $87 million in the first nine months of 2011, as set forth in the following table:

	Nine Months Ended September 30,	
	2012	**2011**
	(in millions)	
Realized investment gains (losses), net—Fixed Maturity Securities—Financial Services Businesses		
Gross realized investment gains:		
Gross gains on sales and maturities(1)	$ 229	$ 391
Private bond prepayment premiums	14	23
Total gross realized investment gains	243	414
Gross realized investment losses:		
Net other-than-temporary impairments recognized in earnings(2)	(238)	(309)
Gross losses on sales and maturities(1)	(176)	(189)
Credit related losses on sales	(23)	(3)
Total gross realized investment losses	(437)	(501)
Realized investment gains (losses), net—Fixed Maturity Securities	$ (194)	$ (87)
Net gains (losses) on sales and maturities—Fixed Maturity Securities(1)	$ 53	$ 202

(1) Amounts exclude prepayment premiums, other-than-temporary impairments, and credit related losses through sales of investments pursuant to our credit risk objectives.
(2) Excludes the portion of other-than-temporary impairments recorded in “Other comprehensive income (loss),” 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.

Net trading gains on sales and maturities of fixed maturity securities in the first nine months of 2012 were $53 million primarily due to sales within our International Insurance, Retirement, and Individual Annuities segments. Included in the net gains on sales and maturities of fixed maturity securities were $3 million of net gains related to the sale of asset-backed securities collateralized by sub-prime mortgages. Net trading gains on sales and maturities of fixed maturity securities in the first nine months of 2011 were $202 million primarily due to sales within our Retirement and Individual Annuities segments. Net gains on sales and maturities in the first nine months of 2011 included $34 million related to asset-backed securities collateralized by sub-prime mortgages. Sales of fixed maturity securities in our Individual Annuities segment in 2012 and 2011 were primarily due to transfers of investments out of our general account and into separate accounts relating to an automatic rebalancing element embedded in the living benefit features of some of our variable annuity products. See “—General Account Investments—Fixed Maturity Securities—Asset-Backed Securities” for additional

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information regarding our exposure to asset-backed securities collateralized by sub-prime mortgages. See below for additional information regarding the other-than-temporary impairments of fixed maturity securities in the first nine months of 2012 and 2011.

Net realized losses on equity securities were $59 million in the first nine months of 2012. The first nine months of 2012 included other-than-temporary equity securities impairments of $93 million and net trading gains on sales of equity securities of $34 million, which were primarily due to sales within our Corporate and Other operations. Net realized losses on equity securities were $98 million in the first nine months of 2011. The first nine months of 2011 included other-than-temporary equity securities impairments of $85 million and net trading losses on sales of equity securities of $13 million, which were primarily due to sales within our International Insurance business. See below for additional information regarding the other-than-temporary impairments of equity securities in the first nine months of 2012 and 2011.

Net realized gains on commercial mortgage and other loans in the first nine months of 2012 were $45 million, primarily related to a net decrease in the loan loss reserve of $46 million and higher servicing revenue within our commercial mortgage operations, which was partially offset by realized losses related to restructurings and sales of loans held within our Retirement segment. Net realized gains on commercial mortgage and other loans in the first nine months of 2011 were $65 million, primarily related to a net decrease in the loan loss reserve of $146 million, which was partially offset by realized losses on related restructurings and sales within our commercial mortgage operations and International Insurance business. For additional information regarding our commercial mortgage and other loan loss reserves, see “—General Account Investments—Commercial Mortgage and Other Loans—Commercial Mortgage and Other Loan Quality.”

Net realized losses on derivatives were $1,012 million in the first nine months of 2012, compared to net realized gains of $2,533 million in the first nine months of 2011. The net derivative gains in the first nine months of 2012 primarily reflect net losses of $1,294 million on product related embedded derivatives and related hedge positions primarily associated with certain variable annuity contracts. Partially offsetting these losses were net mark-to-market gains of $138 million on interest rate derivatives used to manage duration as interest rates decreased and gains of $91 million on fee-based synthetic guaranteed investment contracts which are accounted for as derivatives. The net derivative gains in the first nine months of 2011 primarily reflect net gains of $1,850 million on embedded derivatives and related hedge positions associated with certain variable annuity contracts. Also, contributing to the net derivative gains were net mark-to-market gains of $416 million on interest rate derivatives used to manage duration as interest rates declined, and net gains of $238 million on Star and Edison foreign currency forward contracts used to hedge portfolio assets primarily due to the strengthening of the Japanese yen against the U.S. dollar and Australian dollar. See “—Results of Operations for Financial Services Businesses by Segment—U.S. Retirement Solutions and Investment Management Division—Individual Annuities” for additional information regarding the product related embedded derivatives and related hedge positions associated with certain variable annuity contracts.

Net realized losses on other investments were $64 million in the first nine months of 2012, which included other-than-temporary impairments of $74 million on real estate and joint ventures and partnerships investments, of which $58 million relates to prior periods, partially offset by net trading gains of $10 million, primarily from our Corporate and Other segment. Net realized gains on other investments were $48 million in the first nine months of 2011, which included a $61 million gain on the partial sale of a real estate seed investment and $9 million of net trading gains, partially offset by other other-than-temporary impairments of $22 million on real estate and joint venture and partnership investments.

Related adjustments include that portion of “Realized investment gains (losses), net” that are included in adjusted operating income and that portion of “Asset management fees and other income” and “Net investment income” that are excluded from adjusted operating income. The adjustments are made to arrive at “Realized investment gains (losses), net, and related adjustments” which are excluded from adjusted operating income. Related adjustments to realized investment gains (losses) were a net negative adjustment of $325 million in the first nine months of 2012. Adjustments for that portion of “Realized investment gains (losses), net” that are included in adjusted operating income were a net negative adjustment of $191 million, primarily driven by net gains from settlements on interest rate swaps, partially offset by losses related to the settlements of swaps used to hedge foreign-denominated earnings. Adjustments for that portion of “Asset management fees and other income” and “Net investment income” that are excluded from adjusted operating income were a net negative adjustment of $134 million, primarily driven by the impact of changes in foreign currency exchange rates on certain assets and liabilities for which we economically hedge the foreign currency exposure.

Related adjustments to realized investment gains (losses) were a net positive adjustment of $714 million in the first nine months of 2011. Adjustments for that portion of “Realized investment gains (losses), net” that are included in adjusted operating income were a net negative adjustment of $229 million for the first nine months of 2011, primarily driven by net gains from settlements on interest rate swaps and gains that represent a principal source of earnings for certain of our businesses, partially offset by losses related to the settlements of swaps used to hedge foreign-denominated earnings. Adjustments for that portion of “Asset management fees and other income” and “Net investment income” that are excluded from adjusted operating income were a net positive adjustment of $943 million in the first nine months of 2011, primarily driven by the impact of changes in foreign currency exchange rates on certain assets and liabilities for which we economically hedge the foreign currency exposure. Also included in the $943 million adjustment for the first nine months of 2011 was a $95 million loss from an out of period adjustment recorded in the first quarter of 2011, and a $65 million loss related to our counterparty exposure on derivative transactions we had previously held with Lehman Brothers and affiliates. See Note 11 to the Unaudited Interim Consolidated Financial Statements for further details.

Charges that relate to “Realized investment gains (losses), net” are also excluded from adjusted operating income. Related charges were a net positive adjustment of $498 million and a net negative adjustment of $1,732 million for the first nine months of 2012 and 2011, respectively. These adjustments were primarily driven by that portion of amortization of deferred policy acquisition and other costs relating to net losses and net gains for the first nine months of 2012 and 2011, respectively, on embedded derivatives and related hedge positions associated with certain variable annuity contracts.

During the first nine months of 2012, we recorded other-than-temporary impairments of $405 million in earnings, compared to total other-than-temporary impairments of $416 million recorded in earnings in the first nine months of 2011. The following tables set forth, for the periods indicated, the composition of other-than-temporary impairments recorded in earnings attributable to the Financial Services Businesses by asset type, and for fixed maturity securities, by reason.

	Nine Months Ended September 30,	
	2012	2011
	(in millions)	
Other-than-temporary impairments recorded in earnings—Financial Services Businesses(1)		
Public fixed maturity securities	$ 203	$ 220
Private fixed maturity securities	35	89
Total fixed maturity securities	238	309
Equity securities	93	85
Other invested assets(2)	74	22
Total	$ 405	$ 416

(1) Excludes the portion of other-than-temporary impairments recorded in “Other comprehensive income (loss),” 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.

(2) Includes other-than-temporary impairments relating to investments in joint ventures and partnerships and real estate investments.

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	Nine Months Ended September 30, 2012		
	Asset-Backed Securities Collateralized By Sub-Prime Mortgages	All Other Fixed Maturity Securities	Total Fixed Maturity Securities
		(in millions)	
Other-than-temporary impairments on fixed maturity securities recorded in earnings—Financial Services Businesses(1)			
Due to credit events or adverse conditions of the respective issuer(2)	$ 45	$ 45	$ 90
Due to other accounting guidelines(3)	2	146	148
Total	$ 47	$ 191	$ 238

	Nine Months Ended September 30, 2011		
	Asset-Backed Securities Collateralized By Sub-Prime Mortgages	All Other Fixed Maturity Securities	Total Fixed Maturity Securities
		(in millions)	
Other-than-temporary impairments on fixed maturity securities recorded in earnings—Financial Services Businesses(1)			
Due to credit events or adverse conditions of the respective issuer(2)	$ 71	$ 74	$ 145
Due to other accounting guidelines(3)	12	152	164
Total	$ 83	$ 226	$ 309

(1) Excludes the portion of other-than-temporary impairment recorded in “Other comprehensive income (loss),” 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.
(2) Represents circumstances where we believe credit events or other adverse conditions of the respective issuers have caused, or will lead to, a deficiency in the contractual cash flows related to the investment. The amount of the impairment recorded in earnings is the difference between the amortized cost of the debt security and the net present value of its projected future cash flows discounted at the effective interest rate implicit in the debt security prior to impairment.
(3) Primarily represents circumstances where securities with losses from foreign currency exchange rate movements approach maturity or where we intend to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis.

Fixed maturity other-than-temporary impairments in the first nine months of 2012 were concentrated in the consumer non-cyclical and technology sectors of our corporate securities, and asset-backed securities collateralized by sub-prime mortgages. These other-than-temporary impairments were primarily related to securities with unrealized losses from foreign currency exchange rate movements that are approaching maturity or related to securities with liquidity concerns, downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers, which have caused, or we believe will lead to, a deficiency in the contractual cash flows related to the investment. During the first nine months of 2012, we recorded other-than-temporary impairments of $137 million related to securities with unrealized losses from foreign currency exchange rate movements that are approaching maturity. Our Japanese insurance operations hold non-yen denominated investments which in some cases, due primarily to the strengthening of the yen against the U.S. dollar, are currently in an unrealized loss position. As the securities approach maturity and remain in an unrealized loss position, it becomes less likely that the exchange rates will recover and more likely that losses will be realized upon maturity. Accordingly, additional impairments are to be recorded in earnings as they approach maturity. As of September 30, 2012, gross unrealized losses related to those securities maturing between October 1, 2012 and December 31, 2014 are $357 million. Absent a change in currency rates, impairments of approximately $23 million would be recorded in earnings over the remaining three months of 2012 and approximately $123 million in 2013 on these securities. Fixed maturity other-than-temporary impairments in the first nine months of 2011 were concentrated in the utility, finance, and consumer non-cyclical sectors of our corporate securities, asset-

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backed securities collateralized by sub-prime mortgages, and Japanese commercial mortgage-backed securities. These other-than-temporary impairments were primarily related to securities with unrealized foreign currency translation losses that are approaching maturity or related to securities with liquidity concerns, downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers, which have caused, or we believe will lead to, a deficiency in the contractual cash flows related to the investment.

Equity security other-than-temporary impairments in the first nine months of 2012 and 2011 were primarily driven by circumstances where the decline in value was maintained for one year or greater or where we intend to sell the security.

Other invested assets other-than-temporary impairments in the first nine months of 2012 and 2011 were mainly driven by a decline in value on certain real estate and joint ventures and partnerships investments.

Closed Block Business

For the Closed Block Business, net realized investment gains in the first nine months of 2012 were $218 million, compared to net realized investment gains of $485 million in the first nine months of 2011.

Net realized gains on fixed maturity securities were $46 million in the first nine months of 2012, compared to net realized gains of $89 million in the first nine months of 2011, as set forth in the following table:

	Nine Months Ended September 30,	
	2012	**2011**
	(in millions)	
Realized investment gains (losses), net—Fixed Maturity Securities—Closed Block Business		
Gross realized investment gains:		
Gross gains on sales and maturities(1)	$ 143	$ 204
Private bond prepayment premiums	11	12
Total gross realized investment gains	154	216
Gross realized investment losses:		
Net other-than-temporary impairments recognized in earnings(2)	(62)	(64)
Gross losses on sales and maturities(1)	(38)	(60)
Credit related losses on sales	(8)	(3)
Total gross realized investment losses	(108)	(127)
Realized investment gains (losses), net–Fixed Maturity Securities	$ 46	$ 89
Net gains (losses) on sales and maturities–Fixed Maturity Securities(1)	$ 105	$ 144

(1) Amounts exclude prepayment premiums, other-than-temporary impairments, and credit related losses through sales of investments pursuant to our credit risk objectives.
(2) Excludes the portion of other-than-temporary impairments recorded in “Other comprehensive income (loss),” 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.

Net trading gains on sales and maturities of fixed maturity securities in the first nine months of 2012 and 2011 were $105 and $144 million, respectively. See below for additional information regarding the other-than-temporary impairments of fixed maturity securities in the first nine months of 2012 and 2011.

Net realized gains on equity securities were $62 million in the first nine months of 2012, which included net trading gains on sales of equity securities of $83 million, partially offset by other-than-temporary impairments of $21 million. Net realized gains on equity securities were $224 million in the first nine months of 2011, which

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include net trading gains on sales of equity securities of $240 million, partially offset by other-than-temporary impairments of $16 million. See below for additional information regarding the other-than-temporary impairments of equity securities in the first nine months of 2012 and 2011.

Net realized gains on commercial mortgage and other loans in the first nine months of 2012 were $4 million, primarily related to a net increase in the loan loss reserve. Net realized gains on commercial mortgage and other loans of $15 million in the first nine months of 2011 were primarily related to a net decrease in the loan loss reserve of $23 million, partially offset by realized losses on foreclosures. For additional information regarding our loan loss reserves see “—General Account Investments—Commercial Mortgage and Other Loans—Commercial Mortgage and Other Loan Quality.”

Net realized gains on derivatives were $109 million in the first nine months of 2012, compared to net realized gains of $160 million in the first nine months of 2011. Derivative gains in the first nine months of 2012 primarily reflect net gains of $95 million on interest rate derivatives primarily used to manage duration and net gains of $26 million on “TBA” forward contracts as interest rates declined, partially offset by net losses of $14 million on credit default swaps as credit spreads tightened. The net derivative gains in the first nine months of 2011 primarily reflect net gains of $110 million on interest rate derivatives used to manage duration and $45 million on “TBA” forward contracts as interest rates declined.

Net realized losses on other investments were $3 million in the first nine months of both 2012 and 2011, driven by other-than-temporary impairments on joint ventures and partnership investments in both periods.

During the first nine months of 2012, we recorded other-than-temporary impairments of $86 million in earnings, compared to other-than-temporary impairments of $82 million recorded in earnings in the first nine months of 2011. The following tables set forth, for the periods indicated, the composition of other-than-temporary impairments recorded in earnings attributable to the Closed Block Business by asset type, and for fixed maturity securities, by reason.

	Nine Months Ended September 30,	
	2012	2011
	(in millions)	
Other-than-temporary impairments recorded in earnings—Closed Block Business(1)		
Public fixed maturity securities	$ 48	$ 58
Private fixed maturity securities	14	6
Total fixed maturity securities	62	64
Equity securities	21	16
Other invested assets(2)	3	2
Total	$ 86	$ 82

(1) Excludes the portion of other-than-temporary impairments recorded in “Other comprehensive income (loss),” 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.

(2) Includes other-than-temporary impairments relating to investments in joint ventures and partnerships.

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	Nine Months Ended September 30, 2012		
	Asset-Backed Securities Collateralized By Sub-Prime Mortgages	All Other Fixed Maturity Securities	Total Fixed Maturity Securities
		(in millions)	
Other-than-temporary impairments on fixed maturity securities recorded in earnings—Closed Block Business(1)			
Due to credit events or adverse conditions of the respective issuer(2)	$ 32	$ 29	$ 61
Due to other accounting guidelines	1	0	1
Total	$ 33	$ 29	$ 62

	Nine Months Ended September 30, 2011		
	Asset-Backed Securities Collateralized By Sub-Prime Mortgages	All Other Fixed Maturity Securities	Total Fixed Maturity Securities
		(in millions)	
Other-than-temporary impairments on fixed maturity securities recorded in earnings—Closed Block Business(1)			
Due to credit events or adverse conditions of the respective issuer(2)	$ 41	$ 16	$ 57
Due to other accounting guidelines	6	1	7
Total	$ 47	$ 17	$ 64

(1) Excludes the portion of other-than-temporary impairment recorded in “Other comprehensive income (loss),” 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.

(2) Represents circumstances where we believe credit events or other adverse conditions of the respective issuers have caused, or will lead to, a deficiency in the contractual cash flows related to the investment. The amount of the impairment recorded in earnings is the difference between the amortized cost of the debt security and the net present value of its projected future cash flows discounted at the effective interest rate implicit in the debt security prior to impairment.

Fixed maturity other-than-temporary impairments in the first nine months of 2012 were concentrated in asset-backed securities collateralized by sub-prime mortgages and were primarily driven by liquidity concerns, downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers, which have caused, or we believe will lead to, a deficiency in the contractual cash flows related to the investment. Other-than-temporary impairments in the first nine months of 2011 were concentrated in asset-backed securities collateralized by sub-prime mortgages and were primarily driven by liquidity concerns, downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers, which have caused, or we believe will lead to, a deficiency in the contractual cash flows related to the investment.

Equity security other-than-temporary impairments in the first nine months of 2012 and 2011 were primarily due to circumstances where the decline in value was maintained for one year or greater.

General Account Investments

Portfolio Composition

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

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The following tables set forth the composition of the investments of our general account apportioned between the Financial Services Businesses and the Closed Block Business as of the dates indicated.

	September 30, 2012			
	Financial Services Businesses	Closed Block Business	Total	% of Total
	($ in millions)			
Fixed maturities:				
Public, available-for-sale, at fair value	$ 196,612	$ 29,549	$ 226,161	61.4%
Public, held-to-maturity, at amortized cost	3,438	0	3,438	0.9
Private, available-for-sale, at fair value	28,868	17,817	46,685	12.7
Private, held-to-maturity, at amortized cost	1,282	0	1,282	0.3
Trading account assets supporting insurance liabilities, at fair value	20,132	0	20,132	5.5
Other trading account assets, at fair value	1,653	264	1,917	0.5
Equity securities, available-for-sale, at fair value	4,808	3,171	7,979	2.2
Commercial mortgage and other loans, at book value	26,344	9,765	36,109	9.8
Policy loans, at outstanding balance	6,551	5,150	11,701	3.2
Other long-term investments(1)	4,810	2,022	6,832	1.9
Short-term investments	4,537	1,470	6,007	1.6
Total general account investments	299,035	69,208	368,243	100.0%
Invested assets of other entities and operations(2)	9,829	0	9,829	
Total investments	$ 308,864	$ 69,208	$ 378,072	

	December 31, 2011			
	Financial Services Businesses	Closed Block Business	Total	% of Total
	($ in millions)			
Fixed maturities:				
Public, available-for-sale, at fair value	$ 179,086	$ 30,211	$ 209,297	60.6%
Public, held-to-maturity, at amortized cost	3,743	0	3,743	1.1
Private, available-for-sale, at fair value	26,938	16,305	43,243	12.5
Private, held-to-maturity, at amortized cost	1,364	0	1,364	0.4
Trading account assets supporting insurance liabilities, at fair value	19,481	0	19,481	5.6
Other trading account assets, at fair value	2,104	317	2,421	0.7
Equity securities, available-for-sale, at fair value	4,401	3,122	7,523	2.2
Commercial mortgage and other loans, at book value	25,073	9,040	34,113	9.9
Policy loans, at outstanding balance	6,263	5,296	11,559	3.3
Other long-term investments(1)	4,481	1,990	6,471	1.9
Short-term investments	5,609	528	6,137	1.8
Total general account investments	278,543	66,809	345,352	100.0%
Invested assets of other entities and operations(2)	10,895	0	10,895	
Total investments	$ 289,438	$ 66,809	$ 356,247	

(1) Other long-term investments consist of real estate and non-real estate-related investments in joint ventures and partnerships, investment real estate held through direct ownership and other miscellaneous investments. For additional information regarding these investments, see “—Other Long-Term Investments” below.

(2) Includes invested assets of our trading, banking, and asset management operations. Excludes assets of our asset management operations managed for third parties and those assets classified as “Separate account assets” on our balance sheet. For additional information regarding these investments, see “—Invested Assets of Other Entities and Operations” below.

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As of September 30, 2012, the average duration of our general account investment portfolio attributable to the domestic Financial Services Businesses, including the impact of derivatives, is between 5 and 6 years. The increase in general account investments attributable to the Financial Services Businesses in the first nine months of 2012 was primarily due to portfolio growth as a result of reinvestment of net investment income and net operating inflows, as well as a net increase in fair value driven by a decrease in interest rates. The general account investments attributable to the Closed Block Business also increased in the first nine months of 2012, primarily due to portfolio growth as a result of reinvestment of net investment income and a net increase in fair value driven by a decrease in interest rates, partially offset by net operating outflows. For information regarding the methodology used in determining the fair value of our fixed maturities, see Note 13 to the Unaudited Interim Consolidated Financial Statements.

We have substantial insurance operations in Japan, with 51% and 50% of our Financial Services Businesses’ general account investments relating to our Japanese insurance operations as of September 30, 2012 and December 31, 2011, respectively.

The following table sets forth the composition of the investments of our Japanese insurance operations’ general account as of the dates indicated.

	September 30, 2012	December 31, 2011
	(in millions)	
Fixed Maturities:		
Public, available-for-sale, at fair value	$ 125,028	$ 111,857
Public, held-to-maturity, at amortized cost	3,438	3,743
Private, available-for-sale, at fair value	5,973	5,020
Private, held-to-maturity, at amortized cost	1,282	1,364
Trading account assets supporting insurance liabilities, at fair value	1,833	1,732
Other trading account assets, at fair value	1,367	1,496
Equity securities, available-for-sale, at fair value	2,030	1,932
Commercial mortgage and other loans, at book value	6,179	5,672
Policy loans, at outstanding balance	2,857	2,873
Other long-term investments(1)	2,316	2,892
Short-term investments	467	702
Total Japanese general account investments(2)	$ 152,770	$ 139,283

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

As of September 30, 2012, the average duration of our general account investment portfolio related to our Japanese insurance operations, including the impact of derivatives, was approximately 10 years. The increase in general account investments related to our Japanese insurance operations in the first nine months of 2012 was primarily attributable to the portfolio growth as a result of business inflows and the reinvestment of net investment income, as well as a net increase in fair value primarily driven by declining interest rates, partially offset by the weakening of the yen against the U.S. dollar.

The functional currency of our Japanese insurance subsidiaries is the yen and, although the majority of the Japanese general account is invested in yen-denominated investments, our Japanese insurance operations also hold significant investments denominated in U.S. and Australian dollars.

As of September 30, 2012, our Japanese insurance operations had $44.6 billion, at fair value, of investments denominated in U.S. dollars, including $4.5 billion that were hedged to yen through third party derivative contracts and $31.3 billion that support liabilities denominated in U.S. dollars. As of December 31, 2011, our

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Japanese insurance operations had $38.9 billion, at fair value, of investments denominated in U.S. dollars, including $4.4 billion that were hedged to yen through third party derivative contracts and $25.9 billion that support liabilities denominated in U.S. dollars. The $5.7 billion increase of U.S. dollar investments at fair value from December 31, 2011, is primarily driven by portfolio growth as a result of business inflows and an increase in fair value driven by a decrease in interest rates.

For additional information regarding U.S. dollar investments held in our Japanese insurance operations, see “—Results of Operations for Financial Services Businesses by Segment—International Insurance Division.”

Our Japanese insurance operations had $8.6 billion and $6.4 billion, at fair value, of investments denominated in Australian dollars that support liabilities denominated in Australian dollars as of September 30, 2012 and December 31, 2011, respectively. The $2.2 billion increase of Australian dollar investments at fair value from December 31, 2011, is primarily driven by portfolio growth as a result of business inflows and an increase in fair value driven by a decrease in interest rates.

Eurozone Exposure

Our investment portfolio includes direct investment exposure to the Eurozone region. We define this region as consisting of those countries within the European Union that have adopted the euro as their sole legal currency. The Eurozone region currently consists of seventeen countries, including Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain. Included in this region are peripheral countries, which we currently define as consisting of Portugal, Italy, Ireland, Greece and Spain. Specific country exposure is determined based on the issuer’s country of incorporation.

The following tables set forth the composition of our gross direct exposure to the Eurozone region, by country of incorporation, attributable to our general account, as of September 30, 2012.

Eurozone Gross Direct Exposure—Financial Services Businesses

	September 30, 2012							
	Amortized Cost				Fair Value			
Country	Sovereigns(6)	Financial Institutions(7)	All Other Exposure	Total Amortized Cost	Sovereigns(6)	Financial Institutions(7)	All Other Exposure	Total Fair Value
	(in millions)							
Non-peripheral countries:								
France	$ 361	$ 648	$ 2,158	$ 3,167	$ 366	$ 605	$ 2,347	$ 3,318
Netherlands	26	805	2,401	3,232	25	842	2,496	3,363
Germany	643	300	832	1,775	680	314	854	1,848
Luxembourg	0	297	871	1,168	0	323	901	1,224
Other non-peripheral(1)	138	124	543	805	141	122	558	821
Total non-peripheral exposure	1,168	2,174	6,805	10,147	1,212	2,206	7,156	10,574
Peripheral countries:								
Italy(2)	598	30	242	870	594	31	236	861

Ireland	0	121	467	588	0	127	480	607
Spain	48	27	119	194	45	24	103	172
Other peripheral(3)	0	0	0	0	0	0	0	0
Total peripheral exposure	646	178	828	1,652	639	182	819	1,640
International agencies(4)	0	118	1,559	1,677	0	120	1,657	1,777
Total exposure(5)	$ 1,814	$ 2,470	$ 9,192	$ 13,476	$ 1,851	$ 2,508	$ 9,632	$ 13,991

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Eurozone Gross Direct Exposure—Closed Block Business

	September 30, 2012							
	Amortized Cost				Fair Value			
Country	Sovereigns(6)	Financial Institutions(7)	All Other Exposure	Total Amortized Cost	Sovereigns(6)	Financial Institutions(7)	All Other Exposure	Total Fair Value
	(in millions)							
Non-peripheral countries:								
France	$ 3	$ 99	$ 913	$ 1,015	$ 3	$ 105	$ 1,017	$ 1,125
Netherlands	1	139	758	898	1	142	865	1,008
Germany	6	25	663	694	6	28	715	749
Luxembourg	0	59	495	554	0	65	543	608
Other non-peripheral(1)	1	131	380	512	1	131	405	537
Total non-peripheral exposure	11	453	3,209	3,673	11	471	3,545	4,027
Peripheral countries:								
Italy	5	25	58	88	7	24	61	92
Ireland	0	26	336	362	0	28	358	386
Spain	0	15	69	84	0	14	67	81
Other peripheral(3)	0	0	2	2	0	0	2	2
Total peripheral exposure	5	66	465	536	7	66	488	561
International agencies(4)	0	0	0	0	0	0	0	0
Total exposure(5)	$ 16	$ 519	$ 3,674	$ 4,209	$ 18	$ 537	$ 4,033	$ 4,588

(1) Other non-peripheral countries include Austria, Belgium, Cyprus, Estonia, Finland, Malta, Slovakia, and Slovenia.
(2) Principally represents Italian government securities owned by our Italian insurance operations.
(3) Other peripheral countries include Greece and Portugal.
(4) International agencies include agencies such as Eurofima, European Investment Bank, Council of Europe Development, and Nordic Investment Bank, where a single country of incorporation could not be determined.
(5) For the Financial Services Businesses, of the $13,476 million of amortized cost represented above, 86% is related to fixed maturities, 9% is related to trading account assets supporting insurance liabilities, and the remaining 5% is related to all other asset types. For the Closed Block Business, of the $4,209 million of amortized cost represented above, 94% is related to fixed maturities, and the remaining 6% is related to all other asset types.
(6) Sovereigns include local governments.
(7) Financial institutions include banking, brokerage, non-captive consumer and diversified finance, health insurance, life insurance, property and casualty insurance, other finance and real estate investment trusts.

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Investment Results

The following tables set forth the income yield and investment income for each major investment category of our general account for the periods indicated. The yields are based on net investment income as reported under U.S. GAAP and do not include adjustments, such as settlements of duration management swaps that are included in adjusted operating income.

	Three Months Ended September 30, 2012					
	Financial Services Businesses		Closed Block Business		Combined	
	Yield(1)	Amount	Yield(1)	Amount	Yield(1)	Amount
			($ in millions)			
Fixed maturities	3.69%	$ 1,897	5.37%	$ 532	3.96%	$ 2,429
Trading account assets supporting insurance liabilities	4.00	198	0.00	0	4.00	198
Equity securities	6.49	68	2.89	18	5.16	86
Commercial mortgage and other loans	5.50	356	6.13	149	5.67	505
Policy loans	4.60	73	5.77	74	5.12	147
Short-term investments and cash equivalents	0.24	8	2.12	2	0.27	10
Other investments	5.20	82	5.79	33	5.36	115
Gross investment income before investment expenses	3.83	2,682	5.42	808	4.10	3,490
Investment expenses	(0.11)	(61)	(0.25)	(40)	(0.13)	(101)
Investment income after investment expenses	3.72%	2,621	5.17%	768	3.97%	3,389
Investment results of other entities and operations(2)		44		0		44
Total investment income		$ 2,665		$ 768		$ 3,433

	Three Months Ended September 30, 2011					
	Financial Services Businesses		Closed Block Business		Combined	
	Yield(1)	Amount	Yield(1)	Amount	Yield(1)	Amount
			($ in millions)			
Fixed maturities	3.81%	$ 1,825	5.60%	$ 559	4.12%	$ 2,384
Trading account assets supporting insurance liabilities	4.19	199	0.00	0	4.19	199
Equity securities	5.78	49	2.60	13	4.54	62
Commercial mortgage and other loans	5.44	325	6.26	140	5.66	465
Policy loans	4.72	72	6.13	80	5.38	152
Short-term investments and cash equivalents	0.39	13	0.58	1	0.40	14
Other investments	3.86	80	5.54	33	4.25	113
Gross investment income before investment expenses	3.87	2,563	5.56	826	4.18	3,389
Investment expenses	(0.11)	(59)	(0.24)	(36)	(0.13)	(95)
Investment income after investment expenses	3.76%	2,504	5.32%	790	4.05%	3,294
Investment results of other entities and operations(2)		39		0		39
Total investment income		$ 2,543		$ 790		$ 3,333

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

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cost. Yields for fixed maturities and short-term investments and cash equivalents are calculated net of liabilities and rebate expenses corresponding to securities lending activity. Yields exclude investment income on assets other than those included in invested assets. Prior period’s yields are presented on a basis consistent with the current period presentation.

(2) Includes investment income of trading, banking, and asset management operations.

See below for a discussion of the change in the Financial Services Businesses’ yields. The decrease in net investment income yield attributable to the Closed Block Business for the three months ended September 30, 2012, compared to the three months ended September 30, 2011 was primarily due to lower interest rates on floating rate investments due to rate resets and lower fixed income reinvestment rates.

The following tables set forth the income yield and investment income for each major investment category of our general account, for the periods indicated. The yields are based on net investment income as reported under U.S. GAAP and do not include adjustments, such as settlements of duration management swaps that are included in adjusted operating income.

	Nine Months Ended September 30, 2012					
	Financial Services Businesses		Closed Block Business		Combined	
	Yield(1)	Amount	Yield(1)	Amount	Yield(1)	Amount
			($ in millions)			
Fixed maturities	3.75%	$ 5,610	5.50%	$ 1,619	3.57%	$ 7,229
Trading account assets supporting insurance liabilities	4.05	591	0.00	0	4.05	591
Equity securities	6.11	186	3.19	61	4.98	247
Commercial mortgage and other loans	5.42	1,020	6.17	430	5.62	1,450
Policy loans	4.62	215	5.95	227	5.22	442
Short-term investments and cash equivalents	0.25	24	1.28	6	0.24	30
Other investments	4.09	194	7.55	127	5.01	321
Gross investment income before investment expenses	3.83	7,840	5.59	2,470	4.14	10,310
Investment expenses	(0.11)	(186)	(0.26)	(116)	(0.10)	(302)
Investment income after investment expenses	3.72%	7,654	5.33%	2,354	4.04%	10,008
Investment results of other entities and operations(2)		103		0		103
Total investment income		$ 7,757		$ 2,354		$ 10,111

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	Nine Months Ended September 30, 2011					
	Financial Services Businesses		Closed Block Business		Combined	
	Yield(1)(3)	Amount	Yield(1)	Amount	Yield(1)(3)	Amount
			($ in millions)			
Fixed maturities	3.92%	$ 5,214	5.65%	$ 1,682	4.24%	$ 6,896
Trading account assets supporting insurance liabilities	4.26	584	0.00	0	4.26	584
Equity securities	6.22	185	2.84	58	4.84	243
Commercial mortgage and other loans	5.63	962	6.42	413	5.83	1,375
Policy loans	4.72	205	6.17	241	5.41	446
Short-term investments and cash equivalents	0.42	40	0.65	3	0.43	43
Other investments	4.45	213	7.83	114	5.25	327
Gross investment income before investment expenses	3.99	7,403	5.71	2,511	4.29	9,914
Investment expenses	(0.12)	(172)	(0.25)	(109)	(0.14)	(281)
Investment income after investment expenses	3.87%	7,231	5.46%	2,402	4.15%	9,633
Investment results of other entities and operations(2)		145		0		145
Total investment income		$ 7,376		$ 2,402		$ 9,778

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

(2) Includes investment income of trading, banking, and asset management operations.

(3) Yields for the nine months ended September 30, 2011 are weighted for seven months of income and assets related to the Star and Edison Businesses.

See below for a discussion of the change in the Financial Services Businesses’ yields. The decrease in net investment income yield attributable to the Closed Block Business’ portfolio for the nine months ended September 30, 2012, compared to the nine months ended September 30, 2011, was primarily due to the impact of lower interest rates on floating rate investments due to rate resets and lower fixed income reinvestment rates.

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The following table sets forth the income yield and investment income for each major investment category of the Financial Services Businesses’ general account, excluding the Japanese insurance operations’ portion of the general account which is presented separately below, for the periods indicated. The yields are based on net investment income as reported under U.S. GAAP and do not include adjustments, such as settlements of duration management swaps that are included in adjusted operating income.

	Three Months Ended September 30, 2012		Three Months Ended September 30, 2011	
	Yield(1)	Amount	Yield(1)	Amount
	($ in millions)			
Fixed maturities	5.21%	$ 1,053	5.31%	$ 1,051
Trading account assets supporting insurance liabilities	4.13	186	4.36	188
Equity securities	8.19	46	8.13	37
Commercial mortgage and other loans	5.89	294	5.84	270
Policy loans	5.41	48	5.72	48
Short-term investments and cash equivalents	0.28	7	0.28	6
Other investments	3.91	23	2.83	17
Gross investment income before investment expenses	4.89	1,657	4.92	1,617
Investment expenses	(0.11)	(21)	(0.11)	(22)
Investment income after investment expenses	4.78%	1,636	4.81%	1,595
Investment results of other entities and operations(2)		44		39
Total investment income		$ 1,680		$ 1,634

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

(2) Includes investment income of trading, banking, and asset management operations.

The net investment income yield attributable to the Financial Services Businesses’ general account, excluding the Japanese operations’ portfolio, for the three months ended September 30, 2012, is lower than the net investment income yield for the three months ended September 30, 2011, primarily as a result of lower interest rates on floating rate investments due to rate resets and lower fixed income reinvestment rates.

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The following table sets forth the income yield and investment income for each major investment category of the Financial Services Businesses’ general account, excluding the Japanese insurance operations’ portion of the general account which is presented separately below, for the periods indicated. The yields are based on net investment income as reported under U.S. GAAP and do not include adjustments, such as settlements of duration management swaps that are included in adjusted operating income.

	Nine Months Ended September 30, 2012		Nine Months Ended September 30, 2011	
	Yield(1)	Amount	Yield(1)	Amount
		($ in millions)		
Fixed maturities	5.30%	$ 3,154	5.43%	$ 3,167
Trading account assets supporting insurance liabilities	4.23	561	4.47	556
Equity securities	8.65	136	8.97	129
Commercial mortgage and other loans	5.81	846	6.04	807
Policy loans	5.53	142	5.75	139
Short-term investments and cash equivalents	0.28	20	0.30	20
Other investments	3.49	61	4.46	69
Gross investment income before investment expenses	4.92	4,920	5.07	4,887
Investment expenses	(0.11)	(62)	(0.11)	(67)
Investment income after investment expenses	4.81%	4,858	4.96%	4,820
Investment results of other entities and operations(2)		103		145
Total investment income		$ 4,961		$ 4,965

(1) Yields are annualized, for interim periods, and are based on quarterly average carrying values except for fixed maturities, equity securities and securities lending activity. Yields for fixed maturities are based on amortized cost. Yields for equity securities are based on cost. Yields for fixed maturities and short-term investments and cash equivalents are calculated net of liabilities and rebate expenses corresponding to securities lending activity. Yields exclude investment income on assets other than those included in invested assets. Prior period’s yields are presented on a basis consistent with the current period presentation.
(2) Includes investment income of trading, banking, and asset management operations.

The decrease in net investment income yield attributable to the Financial Services Businesses’ general account, excluding the Japanese operations’ portfolio, for the nine months ended September 30, 2012, compared to the nine months ended September 30, 2011, is primarily the result of lower interest rates on floating rate investments due to rate resets and lower fixed income reinvestment rates.

The following table sets forth the income yield and investment income for each major investment category of our Japanese operations’ general account for the periods indicated. The yields are based on net investment income as reported under U.S. GAAP and do not include adjustments, such as settlements of duration management swaps that are included in adjusted operating income.

	Three Months Ended September 30, 2012		Three Months Ended September 30, 2011	
	Yield(1)	Amount	Yield(1)	Amount
		($ in millions)		
Fixed maturities	2.71%	$ 844	2.75%	$ 774
Trading account assets supporting insurance liabilities	2.63	12	2.54	11
Equity securities	4.58	22	3.70	12

Commercial mortgage and other loans	4.18	62	4.07	55
Policy loans	3.57	25	3.51	24
Short-term investments and cash equivalents	0.14	1	0.70	7
Other investments	6.00	59	4.25	63
Gross investment income before investment expenses	2.83	1,025	2.84	946
Investment expenses	(0.11)	(40)	(0.11)	(37)
Total investment income	2.72%	$ 985	2.73%	$ 909

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

The decrease in net investment income yield on the Japanese insurance portfolio for the three months ended September 30, 2012, compared to the three months ended September 30, 2011, is primarily attributable to lower fixed maturity reinvestment rates in both the U.S. and Japan, partially offset by higher income from our joint ventures and limited partnerships driven by higher gains and appreciation on the underlying assets.

Both the U.S. dollar-denominated and Australian dollar-denominated fixed maturities that are not hedged to yen through third party derivative contracts provide a yield that is substantially higher than the yield on comparable yen-denominated fixed maturities. The average amortized cost of U.S. dollar-denominated fixed maturities that are not hedged to yen through third party derivative contracts for the three months ended September 30, 2012 and 2011, was approximately $30.6 billion and $26.2 billion, respectively. The majority of U.S. dollar-denominated fixed maturities support liabilities that are denominated in U.S. dollars. The average amortized cost of Australian dollar-denominated fixed maturities that are not hedged to yen through third party derivative contracts for the three months ended September 30, 2012 and 2011 was approximately $7.5 billion and $5.4 billion, respectively. These Australian dollar-denominated fixed maturities support liabilities that are denominated in Australian dollars.

For additional information regarding U.S. and Australian dollar investments held in our Japanese insurance operations see, “—Results of Operations for Financial Services Businesses by Segment—International Insurance Division.”

The following table sets forth the income yield and investment income for each major investment category of our Japanese operations’ general account for the periods indicated. The yields are based on net investment income as reported under U.S. GAAP and do not include adjustments, such as settlements of duration management swaps that are included in adjusted operating income.

	Nine Months Ended September 30, 2012		Nine Months Ended September 30, 2011	
	Yield(1)	Amount	Yield(1)(2)	Amount
		($ in millions)		
Fixed maturities	2.73%	$ 2,456	2.74%	$ 2,047
Trading account assets supporting insurance liabilities	2.28	30	2.21	28
Equity securities	3.40	50	3.47	56
Commercial mortgage and other loans	4.09	174	4.15	155
Policy loans	3.50	73	3.44	66
Short-term investments and cash equivalents	0.16	4	0.77	20
Other investments	4.45	133	4.44	144
Gross investment income before investment expenses	2.79	2,920	2.82	2,516
Investment expenses	(0.12)	(124)	(0.12)	(105)
Total investment income	2.67%	$ 2,796	2.70%	$ 2,411

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

(2) Yields for the nine months ended September 30, 2011, are weighted for seven months of income and assets related to the Star and Edison Businesses.

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The decrease in net investment income yield on the Japanese insurance portfolio for the nine months ended September 30, 2012, compared to the nine months ended September 30, 2011, is primarily attributable to lower fixed maturity reinvestment rates and lower interest rates in both the U.S. and Japan, partially offset by asset growth supporting both U.S. and Australian dollar-denominated products.

Both the U.S. dollar-denominated and Australian dollar-denominated fixed maturities that are not hedged to yen through third party derivative contracts provide a yield that is substantially higher than the yield on comparable yen-denominated fixed maturities. The average amortized cost of U.S. dollar-denominated fixed maturities that are not hedged to yen through third party derivative contracts for the nine months ended September 30, 2012 and 2011 was approximately $29.3 billion and $23.2 billion, respectively. The majority of U.S. dollar-denominated fixed maturities support liabilities that are denominated in U.S. dollars. The average amortized cost of Australian dollar-denominated fixed maturities that are not hedged to yen through third party derivative contracts for the nine months ended September 30, 2012 and 2011 was approximately $6.9 billion and $4.5 billion, respectively. These Australian dollar-denominated fixed maturities support liabilities that are denominated in Australian dollars.

For additional information regarding U.S. and Australian dollar investments held in our Japanese insurance operations see, “—Results of Operations for Financial Services Businesses by Segment—International Insurance Division.”

Fixed Maturity Securities

Investment Mix

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

We manage our public portfolio to a risk profile directed or overseen by the Asset Liability Management and Risk Management groups and to a profile that also reflects the local market environments impacting both our domestic and international insurance portfolios. The investment objectives for fixed maturity securities are consistent with those described above. The total return that we earn on the portfolio will be reflected both as investment income and also as realized gains or losses on investments.

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

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Fixed Maturity Securities and Unrealized Gains and Losses by Industry Category

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

Fixed Maturity Securities—Financial Services Businesses

Industry(1)	September 30, 2012 Amortized Cost	Gross Unrealized Gains(2)	Gross Unrealized Losses(2)	Fair Value	December 31, 2011(7) Amortized Cost	Gross Unrealized Gains(2)	Gross Unrealized Losses(2)	Fair Value
	(in millions)							
Corporate Securities:								
Finance	$ 17,871	$ 1,127	$ 381	$ 18,617	$ 18,336	$ 653	$ 775	$ 18,214
Consumer non-cyclical	17,306	1,809	252	18,863	16,064	1,501	373	17,192
Utility	14,409	1,575	305	15,679	13,350	1,188	569	13,969
Capital goods	8,295	832	140	8,987	6,795	561	207	7,149
Consumer cyclical	7,934	684	158	8,460	7,173	507	228	7,452
Foreign agencies	5,834	464	32	6,266	5,371	191	141	5,421
Energy	5,751	693	58	6,386	5,582	548	98	6,032
Communications	5,425	562	128	5,859	5,350	401	224	5,527
Basic industry	4,997	353	80	5,270	4,429	299	112	4,616
Transportation	4,796	457	42	5,211	5,094	370	78	5,386
Technology	3,276	277	58	3,495	3,468	230	95	3,603
Industrial other	2,127	162	6	2,283	3,027	248	22	3,253
Total corporate securities	98,021	8,995	1,640	105,376	94,039	6,697	2,922	97,814
Foreign government(3)	80,708	7,076	89	87,695	73,418	4,749	165	78,002
Residential mortgage-backed	7,518	480	41	7,957	7,569	425	59	7,935
Asset-backed securities(4)	8,235	183	565	7,853	8,319	150	988	7,481
Commercial mortgage-backed	7,706	650	36	8,320	8,197	573	104	8,666
U.S. Government	8,527	2,439	12	10,954	7,592	1,920	17	9,495
State & Municipal(5)	1,984	362	2	2,344	1,751	235	1	1,985
Total(6)	$ 212,699	$ 20,185	$ 2,385	$ 230,499	$ 200,885	$ 14,749	$ 4,256	$ 211,378

(1) Investment data has been classified based on standard industry categorizations for domestic public holdings and similar classifications by industry for all other holdings.
(2) Includes $369 million of gross unrealized gains and $70 million of gross unrealized losses as of September 30, 2012, compared to $345 million of gross unrealized gains and $98 million of gross unrealized losses as of December 31, 2011 on securities classified as held-to-maturity.
(3) As of September 30, 2012 and December 31, 2011, based on amortized cost, 83% and 84%, respectively, represent Japanese government bonds held by our Japanese insurance operations, with no other individual country representing more than 7% and 6%, respectively, of the balance.
(4) Includes securities collateralized by sub-prime mortgages. See “—Asset-Backed Securities” below.
(5) Includes securities related to the Build America Bonds program.
(6) Excluded from the table above are securities held outside the general account in other entities and operations. For additional information regarding investments held outside the general account, see “—Invested Assets of Other Entities and Operations” below. Also excluded from the table above are fixed maturity securities classified as trading. See “—Trading Account Assets Supporting Insurance Liabilities” and “—Other Trading Account Assets” for additional information.
(7) Prior period’s amounts are presented on a basis consistent with the current period presentation.

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The increase in net unrealized gains from December 31, 2011 to September 30, 2012, was primarily due to a net decrease in interest rates in both the U.S. and Japan.

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

Fixed Maturity Securities—Closed Block Business

Industry(1)	September 30, 2012 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	December 31, 2011(5) Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
				(in millions)				
Corporate Securities:								
Utility	$ 4,689	$ 911	$ 15	$ 5,585	$ 4,440	$ 771	$ 38	$ 5,173
Consumer non-cyclical	4,502	820	7	5,315	4,757	761	11	5,507
Finance	3,819	425	26	4,218	3,968	259	82	4,145
Consumer cyclical	3,021	488	10	3,499	2,782	390	20	3,152
Capital goods	2,629	392	2	3,019	1,800	251	7	2,044
Energy	1,902	309	1	2,210	1,813	260	4	2,069
Communications	1,692	287	9	1,970	1,793	208	24	1,977
Basic industry	1,376	175	5	1,546	1,184	134	10	1,308
Transportation	1,347	177	3	1,521	1,338	153	13	1,478
Industrial other	995	101	3	1,093	1,648	165	4	1,809
Technology	651	114	7	758	764	93	15	842
Foreign agencies	391	76	1	466	358	45	3	400
Total corporate securities	27,014	4,275	89	31,200	26,645	3,490	231	29,904
Asset-backed securities(2)	4,823	76	461	4,438	4,935	56	819	4,172
Commercial mortgage-Backed	3,912	197	1	4,108	3,559	158	2	3,715
U.S. Government	3,602	1,024	2	4,624	4,615	951	0	5,566
Residential mortgage-Backed	1,663	116	3	1,776	1,880	125	19	1,986
Foreign government(3)	355	103	2	456	349	75	4	420
State & Municipal	633	132	1	764	657	96	0	753
Total(4)	$ 42,002	$ 5,923	$ 559	$ 47,366	$ 42,640	$ 4,951	$ 1,075	$ 46,516

(1) Investment data has been classified based on standard industry categorizations for domestic public holdings and similar classifications by industry for all other holdings.
(2) Includes securities collateralized by sub-prime mortgages. See “—Asset-Backed Securities” below.
(3) As of September 30, 2012 and December 31, 2011, based on amortized cost, no individual foreign country represented more than 12% and 8%, respectively.
(4) The table above excludes fixed maturity securities classified as trading. See “—Other Trading Account Assets” for additional information.
(5) Prior period’s amounts are presented on a basis consistent with the current period presentation.

The increase in net unrealized gains from December 31, 2011 to September 30, 2012, was primarily due to a net decrease in interest rates.

Asset-Backed Securities

Included within asset-backed securities attributable to both the Financial Services Businesses and the Closed Block Business are securities collateralized by sub-prime mortgages. While there is no market standard definition, we define sub-prime mortgages as residential mortgages that are originated to weaker quality obligors

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as indicated by weaker credit scores, as well as mortgages with higher loan-to-value ratios, or limited documentation. The significant deterioration of the U.S. housing market, high interest rate resets, higher unemployment levels, and relaxed underwriting standards for some originators of sub-prime mortgages have led to higher delinquency rates, particularly for those mortgages issued in 2006 and 2007. Recently there has been significant attention given to potential deficiencies in lenders’ foreclosure documentation, causing delays in the foreclosure process. From the perspective of an investor in securities backed by sub-prime collateral, any significant delays in foreclosure proceedings could result in increased servicing costs which could negatively affect the value of the impacted securities. Separately, as an investor in sub-prime securities, we are pursuing legal and other actions with respect to potential remedies arising from any potential deficiencies related to the original lending and securitization practices.

The following tables set forth the amortized cost and fair value of our asset-backed securities attributable to the Financial Services Businesses as of the dates indicated, by credit quality, and for asset-backed securities collateralized by sub-prime mortgages, by year of issuance (vintage).

Asset-Backed Securities at Amortized Cost—Financial Services Businesses

	September 30, 2012 Lowest Rating Agency Rating						
Vintage	AAA	AA	A	BBB	BB and below	Total Amortized Cost	Total December 31, 2011
				(in millions)			
Collateralized by sub-prime mortgages:							
2012—2008	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
2007	1	0	0	7	438	446	497
2006	7	0	88	14	761	870	1,019
2005	0	8	18	16	260	302	343
2004 & Prior	10	13	66	33	592	714	775
Total collateralized by sub-prime mortgages(1)	18	21	172	70	2,051	2,332	2,634
Other asset-backed securities:							
Externally-managed investments in the European market	0	0	0	108	0	108	452
Collateralized by auto loans	762	0	0	1	2	765	841
Collateralized by credit cards	456	5	120	148	0	729	761
Collateralized by non-sub-prime mortgages	1,439	93	4	27	11	1,574	1,707
Other asset-backed securities(2)	1,047	1,382	112	43	143	2,727	1,924
Total asset-backed securities(3)	$ 3,722	$ 1,501	$ 408	$ 397	$ 2,207	$ 8,235	$ 8,319

(1) Included within the $2.3 billion of asset-backed securities collateralized by sub-prime mortgages as of September 30, 2012, are $34 million of securities collateralized by second-lien exposures.

(2) As of September 30, 2012, includes collateralized debt obligations with amortized cost of $161 million, with none secured by sub-prime mortgages. Also includes asset-backed securities collateralized by education loans, equipment leases, aircraft, franchises, and timeshares.

(3) Excluded from the table above are asset-backed securities held outside the general account in other entities and operations. For additional information regarding asset-backed securities held outside the general account, see “—Invested Assets of Other Entities and Operations” below. Also excluded from the table above are asset-backed securities classified as trading and carried at fair value. See “—Trading Account Assets Supporting Insurance Liabilities” and “—Other Trading Account Assets” for additional information regarding these securities.

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Asset-Backed Securities at Fair Value—Financial Services Businesses

Vintage	September 30, 2012 Lowest Rating Agency Rating AAA	AA	A	BBB	BB and below	Total Fair Value	Total December 31, 2011
				(in millions)			
Collateralized by sub-prime mortgages:							
2012—2008	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
2007	1	0	0	5	319	325	283
2006	5	0	71	12	590	678	664
2005	0	7	17	16	202	242	238
2004 & Prior	9	12	60	27	471	579	546
Total collateralized by sub-prime mortgages	15	19	148	60	1,582	1,824	1,731
Other asset-backed securities:							
Externally-managed investments in the European market	0	0	0	127	0	127	471
Collateralized by auto loans	770	0	0	1	2	773	842
Collateralized by credit cards	480	5	120	145	0	750	783
Collateralized by non-sub-prime mortgages	1,525	95	4	26	11	1,661	1,776
Other asset-backed securities(1)	1,049	1,382	114	45	128	2,718	1,878
Total asset-backed securities(2)	$ 3,839	$ 1,501	$ 386	$ 404	$ 1,723	$ 7,853	$ 7,481

(1) As of September 30, 2012, includes collateralized debt obligations with fair value of $158 million, with none secured by sub-prime mortgages. Also includes asset-backed securities collateralized by education loans, equipment leases, aircraft, franchises, and timeshares.

(2) Excluded from the table above are asset-backed securities held outside the general account in other entities and operations. For additional information regarding asset-backed securities held outside the general account, see “—Invested Assets of Other Entities and Operations” below. Also excluded from the table above are asset-backed securities classified as trading and carried at fair value. See “—Trading Account Assets Supporting Insurance Liabilities” and “—Other Trading Account Assets” for additional information regarding these securities.

The tables above provide ratings as assigned by nationally recognized rating agencies as of September 30, 2012, including Standard & Poor’s, Moody’s, and Fitch. In making our investment decisions, rather than relying solely on the rating agencies’ evaluations, we assign internal ratings to our asset-backed securities based upon our dedicated asset-backed securities unit’s independent evaluation of the underlying collateral and securitization structure, including any guarantees from monoline bond insurers.

On an amortized cost basis, asset-backed securities collateralized by sub-prime mortgages attributable to the Financial Services Businesses decreased from $2.634 billion as of December 31, 2011, to $2.332 billion as of September 30, 2012, primarily reflecting sales, principal paydowns and other-than-temporary impairments recognized. Gross unrealized losses related to our asset-backed securities collateralized by sub-prime mortgages attributable to the Financial Services Businesses were $520 million as of September 30, 2012, and $906 million as of December 31, 2011. For additional information regarding other-than-temporary impairments of asset-backed securities collateralized by sub-prime mortgages see “—Realized Investment Gains and Losses” above. For information regarding the methodology used in determining the fair value of our asset-backed securities collateralized by sub-prime mortgages, see Note 13 to the Unaudited Interim Consolidated Financial Statements.

The weighted average estimated subordination percentage of our asset-backed securities collateralized by sub-prime mortgages attributable to the Financial Services Businesses, excluding those supported by guarantees from monoline bond insurers, was 28% as of September 30, 2012.

The subordination percentage represents the current weighted average estimated percentage of the capital structure subordinated to our investment holding

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that is available to absorb losses before the security incurs the first dollar loss of principal. As of September 30, 2012, based on amortized cost, approximately 58% of the asset-backed securities collateralized by sub-prime mortgages attributable to the Financial Services Businesses have estimated credit subordination percentages of 20% or more, and 39% have estimated credit subordination percentages of 30% or more.

In addition to subordination, certain securities, referred to as front pay or second pay securities, benefit from the prioritization of principal cash flows within the senior tranches of the structure. In most instances, these shorter duration senior securities have priority to principal cash flows over other securities in the structure, including longer duration senior securities. Included within the $2.332 billion of asset-backed securities collateralized by sub-prime mortgages attributable to the Financial Services Businesses as of September 30, 2012, were $433 million of securities, on an amortized cost basis, that represent front pay or second pay securities, depending on the overall structure of the securities.

The following tables set forth the amortized cost and fair value of our asset-backed securities attributable to the Closed Block Business as of the dates indicated, by credit quality, and for asset-backed securities collateralized by sub-prime mortgages, by year of issuance (vintage).

Asset-Backed Securities at Amortized Cost—Closed Block Business

	September 30, 2012 Lowest Rating Agency Rating						
Vintage	**AAA**	**AA**	**A**	**BBB**	**BB and below**	**Total Amortized Cost**	**Total December 31, 2011**
				(in millions)			
Collateralized by sub-prime mortgages:							
2012—2008	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
2007	6	0	20	1	338	365	431
2006	8	83	5	0	780	876	994
2005	9	36	70	21	126	262	296
2004 & Prior	0	5	25	26	468	524	569
Total collateralized by sub-prime mortgages(1)	23	124	120	48	1,712	2,027	2,290
Other asset-backed securities:							
Collateralized by credit cards	234	5	65	146	2	452	659
Collateralized by auto loans	927	0	0	0	0	927	739
Externally-managed investments in the European market	0	0	0	204	0	204	199
Collateralized by education loans	19	438	0	0	0	457	485
Other asset-backed securities(2)	366	303	60	2	25	756	563
Total asset-backed securities(3)	$ 1,569	$ 870	$ 245	$ 400	$ 1,739	$ 4,823	$ 4,935

(1) Included within the $2.0 billion of asset-backed securities collateralized by sub-prime mortgages as of September 30, 2012, are $2 million of securities collateralized by second-lien exposures.
(2) As of September 30, 2012, includes collateralized debt obligations with amortized cost of $42 million, with none secured by sub-prime mortgages. Also includes asset-backed securities collateralized by equipment leases, franchises, aircraft, manufacturing and time shares.
(3) Excluded from the table above are asset-backed securities classified as trading and carried at fair value. For additional information see “—Other Trading Account Assets.”

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Asset-Backed Securities at Fair Value—Closed Block Business

Vintage	September 30, 2012 Lowest Rating Agency Rating AAA	AA	A	BBB (in millions)	BB and below	Total Fair Value	Total December 31, 2011
Collateralized by sub-prime mortgages:							
2012—2008	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
2007	6	0	18	1	255	280	267
2006	8	77	5	0	557	647	597
2005	8	35	64	20	91	218	216
2004 & Prior	0	4	22	23	389	438	421
Total collateralized by sub-prime mortgages	22	116	109	44	1,292	1,583	1,501
Other asset-backed securities:							
Collateralized by credit cards	238	5	65	146	2	456	669
Collateralized by auto loans	931	0	0	0	0	931	739
Externally-managed investments in the European market	0	0	0	241	0	241	233
Collateralized by education loans	19	438	0	0	0	457	474
Other asset-backed securities(1)	371	306	63	1	29	770	556
Total asset-backed securities(2)	$ 1,581	$ 865	$ 237	$ 432	$ 1,323	$ 4,438	$ 4,172

(1) As of September 30, 2012, includes collateralized debt obligations with fair value of $47 million, with none secured by sub-prime mortgages. Also includes asset-backed securities collateralized by equipment leases, franchises, aircraft, manufacturing and time shares.
(2) Excluded from the table above are asset-backed securities classified as trading and carried at fair value. For additional information see “—Other Trading Account Assets.”

On an amortized cost basis, asset-backed securities collateralized by sub-prime mortgages attributable to the Closed Block Business decreased from $2.290 billion as of December 31, 2011, to $2.027 billion as of September 30, 2012, primarily reflecting sales, principal paydowns and other-than-temporary impairments recognized. Gross unrealized losses related to our asset-backed securities collateralized by sub-prime mortgages attributable to the Closed Block Business were $453 million as of September 30, 2012, and $789 million as of December 31, 2011. For additional information regarding other-than-temporary impairments of asset-backed securities collateralized by sub-prime mortgages see “—Realized Investment Gains and Losses” above. For information regarding the methodology used in determining the fair value of our asset-backed securities collateralized by sub-prime mortgages, see Note 13 to the Unaudited Interim Consolidated Financial Statements.

The weighted average estimated subordination percentage of asset-backed securities collateralized by sub-prime mortgages attributable to the Closed Block Business, excluding those supported by guarantees from monoline bond insurers, was 29% as of September 30, 2012. The subordination percentage represents the current weighted average estimated percentage of the capital structure subordinated to our investment holding that is available to absorb losses before the security incurs the first dollar loss of principal. As of September 30, 2012, based on amortized cost, approximately 63% of the asset-backed securities collateralized by sub-prime mortgages attributable to the Closed Block Business have estimated credit subordination percentages of 20% or more, and 42% have estimated credit subordination percentages of 30% or more.

In addition to subordination, certain securities, referred to as front pay or second pay securities, benefit from the prioritization of principal cash flows within the senior tranches of the structure. In most instances, these shorter duration senior securities have priority to principal cash flows over other securities in the structure, including longer duration senior securities. Included within the $2.027 billion of asset-backed securities

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collateralized by sub-prime mortgages attributable to the Closed Block Business as of September 30, 2012, were $411 million of securities, on an amortized cost basis, that represent front pay or second pay securities, depending on the overall structure of the securities.

Residential Mortgage-Backed Securities

The following tables set forth the amortized cost of our residential mortgage-backed securities attributable to the Financial Services Businesses and Closed Block Business as of the dates indicated.

Residential Mortgage-Backed Securities at Amortized Cost

	September 30, 2012			
	Financial Services Businesses		Closed Block Business	
	Amortized Cost	% of Total	Amortized Cost	% of Total
	($ in millions)			
By security type:				
Agency pass-through securities(1)	$ 7,325	97.4%	$ 1,478	88.9%
Collateralized mortgage obligations(2)(3)	193	2.6	185	11.1
Total residential mortgage-backed securities	$ 7,518	100.0%	$ 1,663	100.0%
Portion rated AA or higher(4)	$ 7,407	98.5%	$ 1,478	88.9%

	December 31, 2011			
	Financial Services Businesses		Closed Block Business	
	Amortized Cost	% of Total	Amortized Cost	% of Total
	($ in millions)			
By security type:				
Agency pass-through securities(1)	$ 7,339	97.0%	$ 1,664	88.5%
Collateralized mortgage obligations(2)(3)	230	3.0	216	11.5
Total residential mortgage-backed securities	$ 7,569	100.0%	$ 1,880	100.0%
Portion rated AA or higher(4)	$ 7,489	99.0%	$ 1,664	88.5%

(1) As of September 30, 2012, of these securities, for the Financial Services Businesses, $5.392 billion are supported by the U.S. government and $1.933 billion are supported by foreign governments. As of December 31, 2011, of these securities, for the Financial Services Businesses, $5.408 billion were supported by the U.S. government and $1.931 billion were supported by foreign governments. For the Closed Block Business, all of the securities are supported by the U.S. government as of both September 30, 2012 and December 31, 2011.

(2) Includes alternative residential mortgage loans of $33 million and $38 million in the Financial Services Businesses, and $81 million and $93 million in the Closed Block Business, for September 30, 2012 and December 31, 2011, respectively.

(3) As of September 30, 2012, of these collateralized mortgage obligations, for the Financial Services Businesses, 68% have credit ratings of A or above, 5% have BBB credit ratings and the remaining 27% have below investment grade ratings, and as of December 31, 2011, 68% have credit ratings of A or above, 7% have BBB credit ratings and the remaining 25% have below investment grade ratings. As of September 30, 2012, for the Closed Block Business, 45% have BBB credit ratings, and 55% have below investment grade ratings, and as of December 31, 2011, 16% have A credit ratings or above, 34% have BBB credit ratings, and 50% have below investment grade ratings.

(4) Based on lowest external rating agency rating.

Commercial Mortgage-Backed Securities

The commercial real estate market was severely impacted by the financial crisis and the subsequent recession; however, market fundamentals appear to have bottomed and have been showing signs of improvement since late 2010. Commercial real estate vacancy rates have declined from their peak, rent growth has turned positive for certain sectors, and prices of commercial real estate appear to be stabilizing and improving in some sectors. Additionally, the elevated delinquency rate on mortgages in the commercial mortgage-backed securities

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market is slowing and refinancing activity has increased, at least partially reflecting the improvement in these fundamentals. The loans included in new issues seem to reflect better underwriting and lower levels of leverage compared to 2007.

Although there are some positive signs in commercial real estate, there are still some significant challenges for this market, including numerous future loan workouts, a large wave of refinancings for over-leveraged properties and numerous legislative changes. To ensure our investment objectives and asset strategies are maintained, we consider these market factors in making our investment decisions on commercial mortgage-backed securities.

The following tables set forth the amortized cost and fair value of our commercial mortgage-backed securities attributable to the Financial Services Businesses as of the dates indicated, by credit quality and by year of issuance (vintage).

Commercial Mortgage-Backed Securities at Amortized Cost—Financial Services Businesses

	September 30, 2012 Lowest Rating Agency Rating(1)						
	AAA	AA	A	BBB	BB and below	Total Amortized Cost	Total December 31, 2011
				(in millions)			
Vintage							
2012	$ 3	$ 0	$ 0	$ 0	$ 0	$ 3	$ 0
2011	0	5	0	0	0	5	5
2010	0	99	0	0	0	99	99
2009	0	141	0	0	0	141	117
2008	154	0	0	4	22	180	197
2007	1,273	35	16	0	1	1,325	1,887
2006	2,785	81	40	0	0	2,906	2,955
2005 & Prior	2,799	154	76	11	7	3,047	2,937
Total commercial mortgage-backed securities(2)(3)(4)	$ 7,014	$ 515	$ 132	$ 15	$ 30	$ 7,706	$ 8,197

(1) The table above provides ratings as assigned by nationally recognized rating agencies as of September 30, 2012, including Standard & Poor’s, Moody’s, Fitch and Realpoint.
(2) Excluded from the table above are commercial mortgage-backed securities held outside the general account in other entities and operations. For additional information regarding commercial mortgage-backed securities held outside the general account, see “—Invested Assets of Other Entities and Operations” below. Also excluded from the table above are commercial mortgage-backed securities classified as trading and carried at fair value. See “—Trading Account Assets Supporting Insurance Liabilities” for additional information regarding these securities.
(3) Included in the table above, as of September 30, 2012, are downgraded super senior securities with amortized cost of $93 million in AA and $88 million in A.
(4) Included in the table above, as of September 30, 2012, are agency commercial mortgage-backed securities with amortized cost of $280 million, all rated AA.

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Commercial Mortgage-Backed Securities at Fair Value—Financial Services Businesses

	September 30, 2012 Lowest Rating Agency Rating(1)						
	AAA	AA	A	BBB (in millions)	BB and below	Total Fair Value	Total December 31, 2011
Vintage							
2012	$ 3	$ 0	$ 0	$ 0	$ 0	$ 3	$ 0
2011	0	6	0	0	0	6	5
2010	0	113	0	0	0	113	108
2009	0	160	0	0	0	160	128
2008	171	0	0	4	28	203	206
2007	1,332	40	15	0	26	1,413	1,958
2006	3,070	90	46	0	0	3,206	3,214
2005 & Prior	2,968	150	80	11	7	3,216	3,047
Total commercial mortgage-backed securities(2)(3)	$ 7,544	$ 559	$ 141	$ 15	$ 61	$ 8,320	$ 8,666

(1) The table above provides ratings as assigned by nationally recognized rating agencies as of September 30, 2012, including Standard & Poor’s, Moody’s, Fitch and Realpoint.

(2) Excluded from the table above are commercial mortgage-backed securities held outside the general account in other entities and operations. For additional information regarding commercial mortgage-backed securities held outside the general account, see “—Invested Assets of Other Entities and Operations” below. Also excluded from the table above are commercial mortgage-backed securities classified as trading and carried at fair value. See “—Trading Account Assets Supporting Insurance Liabilities” for additional information regarding these securities.

(3) Included in the table above, as of September 30, 2012, are agency commercial mortgage-backed securities with fair value of $318 million, all rated AA.

Included in the tables above are commercial mortgage-backed securities collateralized by non-U.S. properties, all related to Japanese commercial mortgage-backed securities held by our Japanese insurance operations, with an amortized cost of $13 million in AAA, $3 million in BBB and $23 million in BB and below as of September 30, 2012, and $13 million in AAA, $4 million in A, $17 million in BBB and $13 million in BB and below as of December 31, 2011.

Included in the tables above are commercial mortgage-backed securities collateralized by U.S. properties, all related to commercial mortgage-backed securities held by our Japanese insurance operations, with an amortized cost of $771 million in AAA, $122 million in AA, $48 million in A and $5 million in BBB as of September 30, 2012, and $875 million in AAA, $190 million in AA, $125 million in A, and $5 million in BBB as of December 31, 2011.

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The following table sets forth the amortized cost of our AAA commercial mortgage-backed securities attributable to the Financial Services Businesses as of the dates indicated, by type and by year of issuance (vintage).

AAA Rated Commercial Mortgage-Backed Securities—Amortized Cost by Type and Vintage—Financial Services Businesses

	September 30, 2012							
	Super Senior AAA Structures		Other AAA					
Vintage	Super Senior (shorter duration tranches)	Super Senior (longest duration tranches)	Mezzanine	Junior	Other Senior	Other Subordinate	Other	Total AAA Securities at Amortized Cost
	(in millions)							
2012	$ 3	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 3
2011	0	0	0	0	0	0	0	0
2010	0	0	0	0	0	0	0	0
2009	0	0	0	0	0	0	0	0
2008	154	0	0	0	0	0	0	154
2007	1,273	0	0	0	0	0	0	1,273
2006	1,427	1,345	0	0	0	0	13	2,785
2005 & Prior	395	1,923	0	60	284	135	2	2,799
Total	$ 3,252	$ 3,268	$ 0	$ 60	$ 284	$ 135	$ 15	$ 7,014

The following tables set forth the amortized cost and fair value of our commercial mortgage-backed securities attributable to the Closed Block Business as of the dates indicated, by credit quality and by year of issuance (vintage).

Commercial Mortgage-Backed Securities at Amortized Cost—Closed Block Business

	September 30, 2012						
	Lowest Rating Agency Rating(1)						
Vintage	AAA	AA	A	BBB	BB and below	Total Amortized Cost	Total December 31, 2011
	(in millions)						
2012	$ 129	$ 108	$ 0	$ 0	$ 0	$ 237	$ 0
2011	46	167	0	0	0	213	53
2010	0	48	0	0	0	48	5
2009	0	68	0	0	0	68	0
2008	6	0	0	0	0	6	3
2007	521	43	28	0	4	596	831
2006	1,178	139	25	0	0	1,342	933
2005 & Prior	1,340	29	25	5	3	1,402	1,734
Total commercial mortgage-backed securities(2)(3)	$ 3,220	$ 602	$ 78	$ 5	$ 7	$ 3,912	$ 3,559

(1) The table above provides ratings as assigned by nationally recognized rating agencies as of September 30, 2012, including Standard & Poor’s, Moody’s, Fitch and Realpoint.
(2) Included in the table above, as of September 30, 2012, are downgraded super senior securities with amortized cost of $139 million in AA and $78 million in A.
(3) Included in the table above, as of September 30, 2012, are agency commercial mortgage-backed securities with amortized cost of $434 million, all rated AA.

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Commercial Mortgage-Backed Securities at Fair Value—Closed Block Business

	September 30, 2012 Lowest Rating Agency Rating(1)						
	AAA	AA	A	BBB (in millions)	BB and below	Total Fair Value	Total December 31, 2011
Vintage							
2012	$ 132	$ 112	$ 0	$ 0	$ 0	$ 244	$ 0
2011	51	175	0	0	0	226	57
2010	0	51	0	0	0	51	5
2009	0	71	0	0	0	71	0
2008	6	0	0	0	0	6	4
2007	538	45	29	0	13	625	860
2006	1,249	146	26	0	0	1,421	986
2005 & Prior	1,399	29	28	5	3	1,464	1,803
Total commercial mortgage-backed securities(2)	$ 3,375	$ 629	$ 83	$ 5	$ 16	$ 4,108	$ 3,715

(1) The table above provides ratings as assigned by nationally recognized rating agencies as of September 30, 2012, including Standard & Poor’s, Moody’s, Fitch and Realpoint.
(2) Included in the table above, as of September 30, 2012, are agency commercial mortgage-backed securities with fair value of $454 million, all rated AA.

The following table sets forth the amortized cost of our AAA commercial mortgage-backed securities attributable to the Closed Block Business as of the dates indicated, by type and by year of issuance (vintage).

AAA Rated Commercial Mortgage-Backed Securities—Amortized Cost by Type and Vintage—Closed Block Business

	September 30, 2012							
	Super Senior AAA Structures			Other AAA				
	Super Senior (shorter duration tranches)	Super Senior (longest duration tranches)	Mezzanine	Junior	Other Senior (in millions)	Other Subordinate	Other	Total AAA Securities at Amortized Cost
Vintage								
2012	$ 129	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 129
2011	46	0	0	0	0	0	0	46
2010	0	0	0	0	0	0	0	0
2009	0	0	0	0	0	0	0	0
2008	6	0	0	0	0	0	0	6
2007	521	0	0	0	0	0	0	521
2006	551	622	0	0	0	0	5	1,178
2005 & Prior	627	540	0	0	138	35	0	1,340
Total	$ 1,880	$ 1,162	$ 0	$ 0	$ 138	$ 35	$ 5	$ 3,220

Fixed Maturity Securities Credit Quality

The Securities Valuation Office, or SVO, of the NAIC, evaluates the investments of insurers for statutory reporting purposes and assigns fixed maturity securities to one of six categories called “NAIC Designations.” In general, NAIC Designations of “1” highest quality, or “2” high quality, include fixed maturities considered investment grade, which include securities rated Baa3 or higher by Moody’s or BBB- or higher by Standard & Poor’s. NAIC Designations of “3” through “6” generally include fixed maturities referred to as below investment grade, which include securities rated Ba1 or lower by Moody’s and BB+ or lower by Standard & Poor’s. The NAIC Designations for commercial mortgage-backed securities and non-agency residential

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mortgage-backed securities, including our asset-backed securities collateralized by sub-prime mortgages, are based on security level expected losses as modeled by an independent third party (engaged by the NAIC) and the statutory carrying value of the security, including any purchase discounts or impairment charges previously recognized.

As a result of time lags between the funding of investments, the finalization of legal documents, and the completion of the SVO filing process, the fixed maturity portfolio generally includes securities that have not yet been rated by the SVO as of each balance sheet date. Pending receipt of SVO ratings, the categorization of these securities by NAIC Designation is based on the expected ratings indicated by internal analysis.

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

The amortized cost of our public and private fixed maturities attributable to the Financial Services Businesses considered other than high or highest quality, based on NAIC or equivalent rating, totaled $8.6 billion, or 4%, of the total fixed maturities as of September 30, 2012, and $9.3 billion, or 5%, of the total fixed maturities as of December 31, 2011. Fixed maturities considered other than high or highest quality, based on NAIC or equivalent rating, represented 27% and 30% of the gross unrealized losses attributable to the Financial Services Businesses as of September 30, 2012 and December 31, 2011, respectively. As of September 30, 2012, the amortized cost of our public and private below investment grade fixed maturities attributable to the Financial Services Businesses, based on the lowest of external rating agency ratings, totaled $10.3 billion, or 5%, of the total fixed maturities, and include securities considered high or highest quality by the NAIC based on the rules described above.

The amortized cost of our public and private fixed maturities attributable to the Closed Block Business considered other than high or highest quality, based on NAIC or equivalent rating, totaled $3.6 billion, or 9%, of the total fixed maturities as of September 30, 2012, and $4.4 billion, or 10%, of the total fixed maturities as of December 31, 2011. Fixed maturities considered other than high or highest quality, based on NAIC or equivalent rating, represented 49% and 51% of the gross unrealized losses attributable to the Closed Block Business as of September 30, 2012 and December 31, 2011, respectively. As of September 30, 2012, the amortized cost of our public and private below investment grade fixed maturities attributable to the Closed Block Business, based on the lowest of external rating agency ratings, totaled $4.8 billion, or 11%, of the total fixed maturities, and include securities considered high or highest quality by the NAIC based on the rules described above.

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Public Fixed Maturities—Credit Quality

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

Public Fixed Maturity Securities—Financial Services Businesses

(1)(2) NAIC Designation	September 30, 2012 Amortized Cost	Gross Unrealized Gains(3)	Gross Unrealized Losses(3)	Fair Value	December 31, 2011 Amortized Cost	Gross Unrealized Gains(3)	Gross Unrealized Losses(3)	Fair Value
				(in millions)				
1	$ 162,378	$ 15,565	$ 918	$ 177,025	$ 151,700	$ 11,143	$ 1,756	$ 161,087
2	17,408	1,805	476	18,737	17,017	1,298	797	17,518
Subtotal High or Highest Quality Securities	179,786	17,370	1,394	195,762	168,717	12,441	2,553	178,605
3	3,152	77	281	2,948	3,446	66	574	2,938
4	1,254	76	150	1,180	1,328	34	296	1,066
5	376	8	108	276	443	6	174	275
6	123	13	28	108	219	15	105	129
Subtotal Other Securities(4)	4,905	174	567	4,512	5,436	121	1,149	4,408
Total Public Fixed Maturities	$ 184,691	$ 17,544	$ 1,961	$ 200,274	$ 174,153	$ 12,562	$ 3,702	$ 183,013

(1) Reflects equivalent ratings for investments of our international insurance operations.
(2) Includes, as of September 30, 2012 and December 31, 2011, 5 securities with amortized cost of $4 million (fair value, $9 million) and 10 securities with amortized cost of $2 million (fair value, $12 million), respectively, that have been categorized based on expected NAIC Designations pending receipt of SVO ratings.
(3) Includes $294 million of gross unrealized gains and $70 million gross unrealized losses as of September 30, 2012, compared to $282 million of gross unrealized gains and $97 million of gross unrealized losses as of December 31, 2011, on securities classified as held-to-maturity.
(4) On an amortized cost basis, as of September 30, 2012, includes $179 million in emerging market securities and $48 million in securitized bank loans.

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

Public Fixed Maturity Securities—Closed Block Business

(1) NAIC Designation	September 30, 2012 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	December 31, 2011 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
				(in millions)				
1	$ 20,006	$ 2,882	$ 213	$ 22,675	$ 21,098	$ 2,424	$ 381	$ 23,141
2	4,475	856	61	5,270	4,638	629	134	5,133

Subtotal High or Highest Quality Securities	24,481	3,738	274	27,945	25,736	3,053	515	28,274
3	933	60	77	916	1,103	59	82	1,080
4	615	17	127	505	808	14	245	577
5	189	10	46	153	369	5	156	218
6	21	12	3	30	66	10	14	62
Subtotal Other Securities(2)	1,758	99	253	1,604	2,346	88	497	1,937
Total Public Fixed Maturities	$ 26,239	$ 3,837	$ 527	$ 29,549	$ 28,082	$ 3,141	$ 1,012	$ 30,211

(1) Includes, as of September 30, 2012 and December 31, 2011, 5 securities with amortized cost of $7 million (fair value, $11 million) and 11 securities with amortized cost of $11 million (fair value, $13 million), respectively, that have been categorized based on expected NAIC Designations pending receipt of SVO ratings.

(2) On an amortized cost basis, as of September 30, 2012, includes $209 million in securitized bank loans and $148 million in emerging markets securities.

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Private Fixed Maturities—Credit Quality

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

Private Fixed Maturity Securities—Financial Services Businesses

(1)(2)	September 30, 2012				December 31, 2011			
NAIC Designation	Amortized Cost	Gross Unrealized Gains(3)	Gross Unrealized Losses(3)	Fair Value	Amortized Cost	Gross Unrealized Gains(3)	Gross Unrealized Losses(3)	Fair Value
				(in millions)				
1	$ 7,113	$ 804	$ 63	$ 7,854	$ 7,018	$ 730	$ 84	$ 7,664
2	17,180	1,574	293	18,461	15,847	1,273	362	16,758
Subtotal High or Highest Quality Securities	24,293	2,378	356	26,315	22,865	2,003	446	24,422
3	2,472	180	37	2,615	2,532	134	43	2,623
4	675	37	7	705	715	14	20	709
5	406	15	19	402	490	5	42	453
6	162	31	5	188	130	31	3	158
Subtotal Other Securities(4)	3,715	263	68	3,910	3,867	184	108	3,943
Total Private Fixed Maturities	$ 28,008	$ 2,641	$ 424	$ 30,225	$ 26,732	$ 2,187	$ 554	$ 28,365

(1) Reflects equivalent ratings for investments of our international insurance operations.
(2) Includes, as of September 30, 2012 and December 31, 2011, 133 securities with amortized cost of $1,314 million (fair value, $1,378 million) and 100 securities with amortized cost of $815 million (fair value, $840 million), respectively, that have been categorized based on expected NAIC Designations pending receipt of SVO ratings.
(3) Includes $75 million of gross unrealized gains and no gross unrealized losses as of September 30, 2012, compared to $63 million of gross unrealized gains and $1 million of gross unrealized losses as of December 31, 2011, on securities classified as held-to-maturity.
(4) On an amortized cost basis, as of September 30, 2012, includes $358 million in securitized bank loans and $273 million in commercial asset finance securities.

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

Private Fixed Maturity Securities—Closed Block Business

(1)	September 30, 2012				December 31, 2011			
NAIC Designation	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
				(in millions)				
1	$ 3,939	$ 754	$ 0	$ 4,693	$ 3,651	$ 660	$ 0	$ 4,311
2	9,971	1,215	12	11,174	8,861	1,069	16	9,914
Subtotal High or Highest Quality Securities	13,910	1,969	12	15,867	12,512	1,729	16	14,225
3	1,021	87	4	1,104	1,061	66	10	1,117
4	519	13	5	527	618	11	16	613
5	216	3	9	210	215	1	18	198
6	97	14	2	109	152	3	3	152
Subtotal Other Securities(2)	1,853	117	20	1,950	2,046	81	47	2,080
Total Private Fixed Maturities	$ 15,763	$ 2,086	$ 32	$ 17,817	$ 14,558	$ 1,810	$ 63	$ 16,305

(1) Includes, as of September 30, 2012 and December 31, 2011, 64 securities with amortized cost of $1,150 million (fair value, $1,202 million) and 56 securities with amortized cost of $926 million (fair value, $968 million), respectively, that have been categorized based on expected NAIC Designations pending receipt of SVO ratings.

(2) On an amortized cost basis, as of September 30, 2012, includes $257 million in commercial asset finance securities and $251 million in securitized bank loans.

Corporate Securities—Credit Quality

The following table sets forth both our public and private corporate securities by NAIC Designation attributable to the Financial Services Businesses as of the dates indicated.

Corporate Securities—Financial Services Businesses

(1)	September 30, 2012				December 31, 2011(2)			
NAIC Designation	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
				(in millions)				
1	$ 57,179	$ 5,399	$ 573	$ 62,005	$ 54,927	$ 3,954	$ 1,165	$ 57,716
2	33,422	3,248	712	35,958	31,355	2,488	1,073	32,770

Subtotal High or Highest Quality Securities	90,601	8,647	1,285	97,963	86,282	6,442	2,238	90,486
3	5,288	242	260	5,270	5,529	185	512	5,202
4	1,483	56	62	1,477	1,467	26	109	1,384
5	457	13	27	443	585	9	51	543
6	192	37	6	223	176	35	12	199
Subtotal Other Securities	7,420	348	355	7,413	7,757	255	684	7,328
Total Corporate Fixed Maturities	$ 98,021	$ 8,995	$ 1,640	$ 105,376	$ 94,039	$ 6,697	$ 2,922	$ 97,814

(1) Reflects equivalent ratings for investments of our international insurance operations.
(2) Prior period’s amounts are presented on a basis consistent with the current period presentation.

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The following table sets forth our corporate securities by NAIC Designation attributable to the Closed Block Business as of the dates indicated.

Corporate Securities—Closed Block Business

	September 30, 2012				December 31, 2011(1)			
NAIC Designation	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
				(in millions)				
1	$ 10,556	$ 2,109	$ 24	$ 12,641	$ 10,651	$ 1,718	$ 63	$ 12,306
2	13,812	1,985	27	15,770	12,798	1,633	67	14,364
Subtotal High or Highest Quality Securities	24,368	4,094	51	28,411	23,449	3,351	130	26,670
3	1,511	124	7	1,628	1,738	104	21	1,821
4	753	26	13	766	951	21	42	930
5	269	10	15	264	299	6	26	279
6	113	21	3	131	208	8	12	204
Subtotal Other Securities	2,646	181	38	2,789	3,196	139	101	3,234
Total Corporate Fixed Maturities	$ 27,014	$ 4,275	$ 89	$ 31,200	$ 26,645	$ 3,490	$ 231	$ 29,904

(1) Prior period’s amounts are presented on a basis consistent with the current period presentation.

Credit Derivative Exposure to Public Fixed Maturities

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

In a credit derivative, we sell credit protection on an identified name, and in return receive a quarterly premium. With single name credit default derivatives, this premium or credit spread generally corresponds to the difference between the yield on the referenced name’s public fixed maturity cash instruments and swap rates at the time the agreement is executed.

The referenced names in the credit derivatives where we have sold credit protection, as well as all the counterparties to these agreements, are investment grade credit quality and our credit derivatives have a remaining term to maturity of four years or less. Credit derivative contracts are recorded at fair value with changes in fair value, including the premium received, recorded in “Realized investment gains (losses), net.” The premium received for the credit derivatives we sell attributable to the Financial Services Businesses was $0 million and $2 million for the three and nine months ended September 30, 2012, respectively, and $2 million and $5 million for the three and nine months ended September 30, 2011, respectively, and is included in adjusted operating income as an adjustment to “Realized investment gains (losses), net.”

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

Credit Derivatives, Sold Protection—Financial Services Businesses

NAIC Designation	September 30, 2012 Single Name Notional	September 30, 2012 Single Name Fair Value	December 31, 2011 Single Name Notional	December 31, 2011 Single Name Fair Value
	(in millions)			
1	$ 290	$ 1	$ 745	$ 3
2	25	0	25	0
Subtotal	315	1	770	3
3 through 6	0	0	0	0
Total(1)	$ 315	$ 1	$ 770	$ 3

(1) Excludes a credit derivative related to surplus notes issued by a subsidiary of Prudential Insurance and embedded derivatives contained in certain externally-managed investments in the European market. See Note 14 to the Unaudited Interim Consolidated Financial Statements for additional information regarding these derivatives.

As of September 30, 2012 and December 31, 2011, the Closed Block Business had $5 million and $50 million of outstanding notional amounts, respectively, reported at fair value as an asset of less than $1 million of exposure where we have sold credit protection through credit derivatives.

In addition to selling credit protection, we have purchased credit protection using credit derivatives in order to hedge specific credit exposures in our investment portfolio, including exposures relating to certain guarantees from monoline bond insurers. As of September 30, 2012 and December 31, 2011, the Financial Services Businesses had $1.384 billion and $1.598 billion of outstanding notional amounts, reported at fair value as a liability of $25 million and an asset of $2 million, respectively. As of September 30, 2012 and December 31, 2011, the Closed Block Business had $344 million and $381 million of outstanding notional amounts, reported at fair value as a liability of $8 million and an asset of less than $1 million, respectively. The premium paid for the credit derivatives we purchase attributable to the Financial Services Businesses was $9 million and $29 million for the three and nine months ended September 30, 2012, and $11 million and $33 million for the three and nine months ended September 30, 2011, respectively, and is included in adjusted operating income as an adjustment to “Realized investment gains (losses), net.” See Note 14 to the Unaudited Interim Consolidated Financial Statements for additional information regarding credit derivatives and an overall description of our derivative activities.

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Unrealized Losses from Fixed Maturity Securities

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

Unrealized Losses from Fixed Maturity Securities, Greater than 20%—Financial Services Businesses

	September 30, 2012		December 31, 2011	
	Amortized Cost(1)	Gross Unrealized Losses(1)	Amortized Cost(1)	Gross Unrealized Losses(1)
	(in millions)			
Less than three months	$ 252	$ 52	$ 1,371	$ 349
Three months or greater but less than six months	514	116	1,667	399
Six months or greater but less than nine months	239	60	864	309
Nine months or greater but less than twelve months	107	32	745	193
Greater than twelve months	3,574	1,074	3,809	1,392
Total	$ 4,686	$ 1,334	$ 8,456	$ 2,642

(1) The aging of amortized cost and gross unrealized losses is determined based upon a count of the number of months the estimated fair value remained below amortized cost by 20% or more, using month-end valuations.

The gross unrealized losses were primarily attributable to foreign currency exchange rate movements, general credit spread widening in the structured credit marketplace and liquidity discounts as of September 30, 2012 and December 31, 2011. Gross unrealized losses attributable to the Financial Services Businesses, where the estimated fair value had declined and remained below amortized cost by 20% or more, of $1.334 billion as of September 30, 2012 includes $404 million relating to asset-backed securities collateralized by sub-prime mortgages. Also included in gross unrealized losses were $35 million of gross unrealized losses on securities with amortized cost of $57 million where the estimated fair value had declined and remained below amortized cost by 50% or more, of which $2 million was included in the less than three months timeframe, $1 million was included in the three months or greater but less than twelve months timeframe, and $32 million was included in the greater than twelve months timeframe. We have not recognized the gross unrealized losses shown in the tables above as other-than-temporary impairments in earnings based on our detailed analysis of the underlying credit and cash flows on each of these securities. We believe the recoverable value of these investments based on the expected future cash flows is greater than or equal to our remaining amortized cost. At September 30, 2012, we do not intend to sell these securities and it is not more likely than not that we will be required to sell these securities before the anticipated recovery of its remaining amortized cost basis. See “—Other-Than-Temporary Impairments of Fixed Maturity Securities” for a discussion of the factors we consider in making these determinations.

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

Unrealized Losses from Fixed Maturity Securities, Greater than 20%—Closed Block Business

	September 30, 2012		December 31, 2011	
	Amortized Cost(1)	Gross Unrealized Losses(1)	Amortized Cost(1)	Gross Unrealized Losses(1)
	(in millions)			
Less than three months	$ 4	$ 1	$ 122	$ 33
Three months or greater but less than six months	16	3	353	90
Six months or greater but less than nine months	1	1	179	55
Nine months or greater but less than twelve months	23	5	122	34
Greater than twelve months	1,083	368	1,263	605
Total	$ 1,127	$ 378	$ 2,039	$ 817

(1) The aging of amortized cost and gross unrealized losses is determined based upon a count of the number of months the estimated fair value remained below amortized cost by 20% or more, using month-end valuations.

The gross unrealized losses were primarily attributable to general credit spread widening in the structured credit marketplace, liquidity discounts and foreign currency exchange rate movements as of September 30, 2012 and December 31, 2011. Gross unrealized losses attributable to the Closed Block Business, where the estimated fair value had declined and remained below amortized cost by 20% or more, of $378 million as of September 30, 2012 include $347 million relating to asset-backed securities collateralized by sub-prime mortgages. Gross unrealized losses attributable to the Closed Block Business where the estimated fair value had declined and remained below amortized cost by 20% or more as of September 30, 2012 does not include any gross unrealized losses on securities where the estimated fair value had declined and remained below amortized cost by 50% or more. We have not recognized the gross unrealized losses shown in the tables above as other-than-temporary impairments in earnings based on our detailed analysis of the underlying credit and cash flows on each of these securities. We believe the recoverable value of these investments based on the expected future cash flows is greater than or equal to our remaining amortized cost. At September 30, 2012, we do not intend to sell these securities and it is not more likely than not that we will be required to sell these securities before the anticipated recovery of its remaining amortized cost basis. See “—Other-Than-Temporary Impairments of Fixed Maturity Securities” for a discussion of the factors we consider in making these determinations.

Other-Than-Temporary Impairments of Fixed Maturity Securities

We maintain separate monitoring processes for public and private fixed maturities and create watch lists to highlight securities that require special scrutiny and management. Our public fixed maturity asset managers formally review all public fixed maturity holdings on a quarterly basis and more frequently when necessary to identify potential credit deterioration whether due to ratings downgrades, unexpected price variances, and/or company or industry specific concerns.

For private placements, our credit and portfolio management processes help ensure prudent controls over valuation and management. We have separate pricing and authorization processes to establish “checks and balances” for new investments. We apply consistent standards of credit analysis and due diligence for all transactions, whether they originate through our own in-house origination staff or through agents. Our regional offices closely monitor the portfolios in their regions. We set all valuation standards centrally, and we assess the fair value of all investments quarterly. Our private fixed maturity asset managers formally review all private fixed maturity holdings on a quarterly basis and more frequently when necessary to identify potential credit deterioration whether due to ratings downgrades, unexpected price variances, and/or company or industry specific concerns.

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Fixed maturity securities classified as held-to-maturity are those securities where we have the intent and ability to hold the securities until maturity. These securities are reflected at amortized cost in our consolidated statements of financial position. Other fixed maturity securities are considered available-for-sale and, as a result, we record unrealized gains and losses to the extent that amortized cost is different from estimated fair value. All held-to-maturity securities and all available-for-sale securities with unrealized losses are subject to our review to identify other-than-temporary impairments in value.

In evaluating whether a decline in value is other-than-temporary, we consistently consider several factors including, but not limited to, the following:

• the reasons for the decline in value (credit event, currency or interest rate related, including general credit spread widening);

• the financial condition of and near-term prospects of the issuer; and

• the extent and duration of the decline.

In determining whether a decline in value is other-than-temporary, we place greater emphasis on our analysis of the underlying credit versus the extent and duration of a decline in value. Our credit analysis of an investment includes determining whether the issuer is current on its contractual payments, evaluating whether it is probable that we will be able to collect all amounts due according to the contractual terms of the security, and analyzing our overall ability to recover the amortized cost of the investment. We continue to utilize valuation declines as a potential indicator of credit deterioration, and apply additional levels of scrutiny in our analysis as the severity and duration of the decline increases.

In addition, we recognize an other-than-temporary impairment in earnings for a debt security in an unrealized loss position when (a) we have the intent to sell the debt security, or (b) it is more likely than not we will be required to sell the debt security before its anticipated recovery, or (c) a foreign currency denominated security with a foreign currency translation loss approaches maturity. For all debt securities in unrealized loss positions that do not meet any of these criteria, we analyze our ability to recover the amortized cost by comparing the net present value of our best estimate of projected future cash flows with the amortized cost of the security. If the net present value is less than the amortized cost of the investment, an other-than-temporary impairment is recorded. The determination of the assumptions used in these projections requires the use of significant management judgment. See Note 2 to the Unaudited Interim Consolidated Financial Statements for additional information regarding these assumptions and our policies for recognizing other-than-temporary impairments for debt securities.

Other-than-temporary impairments of general account fixed maturity securities attributable to the Financial Services Businesses that were recognized in earnings were $82 million and $101 million for the three months ended September 30, 2012 and 2011, respectively, and $238 million and $309 million for the nine months ended September 30, 2012 and 2011, respectively. Included in the other-than-temporary impairments of general account fixed maturities attributable to the Financial Services Businesses for the three months ended September 30, 2012 and 2011, were $13 million and $24 million, respectively, of other-than-temporary impairments on asset-backed securities collateralized by sub-prime mortgages. Other-than-temporary impairments of general account fixed maturities attributable to the Financial Services Businesses for the nine months ended September 30, 2012 and 2011 include $47 million and $83 million, respectively, of other-than-temporary impairments on asset-backed securities collateralized by sub-prime mortgages.

Other-than-temporary impairments of fixed maturity securities attributable to the Closed Block Business that were recognized in earnings were $13 million and $15 million for the three months ended September 30, 2012, and 2011, respectively, and $62 million and $64 million for the nine months ended September 30, 2012 and 2011, respectively. Included in the other-than-temporary impairments of fixed maturities attributable to the Closed Block Business for the three months ended September 30, 2012, and 2011, were $7 million and $9 million, respectively, of other-than-temporary impairments on asset-backed securities collateralized by sub-prime mortgages. Other-than-temporary impairments of general account fixed maturities attributable to the Closed Block Business for the nine months ended September 30, 2012 and 2011 include $33 million and $47 million, respectively, of other-than-temporary impairments on asset-backed securities collateralized by sub-prime mortgages. For a further discussion of other-than-temporary impairments, see “—Realized Investment Gains and Losses” above.

Trading account assets supporting insurance liabilities

Certain products included in the Retirement and International Insurance segments are experience-rated, meaning that we expect the investment results associated with these products will ultimately accrue to contractholders. The investments supporting these experience-rated products, excluding commercial mortgage and other loans, are primarily classified as trading and are reflected on the balance sheet as “Trading account assets supporting insurance liabilities, at fair value.” Realized and unrealized gains and losses for these investments are reported in “Asset management fees and other income,” and excluded from adjusted operating income. Investment income for these investments is reported in “Net investment income,” and is included in adjusted operating income.

The following table sets forth the composition of this portfolio as of the dates indicated.

	September 30, 2012		December 31, 2011(1)	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(in millions)			
Short-term investments and cash equivalents	$ 640	$ 640	$ 951	$ 951
Fixed maturities:				
Corporate securities	11,122	12,153	10,369	11,113
Commercial mortgage-backed securities	1,951	2,095	2,157	2,247
Residential mortgage-backed securities	1,799	1,880	1,786	1,844
Asset-backed securities	1,227	1,150	1,504	1,367
Foreign government bonds	736	756	599	608
U.S. government authorities and agencies and obligations of U.S. states	408	455	413	440
Total fixed maturities	17,243	18,489	16,828	17,619
Equity securities	1,029	1,003	1,050	911
Total trading account assets supporting insurance liabilities	$ 18,912	$ 20,132	$ 18,829	$ 19,481

(1) Prior period’s amounts are presented on a basis consistent with the current period presentation.

As a percentage of amortized cost, 74% and 75% of the portfolio was publicly-traded as of September 30, 2012 and December 31, 2011, respectively. As of September 30, 2012 and December 31, 2011, 93% and 92%, respectively, of the fixed maturity portfolio was considered high or highest quality based on NAIC or equivalent rating. As of September 30, 2012, $1.696 billion of the residential mortgage-backed securities were publicly-traded agency pass-through securities, which are supported by implicit or explicit government guarantees, of which 99% have credit ratings of A or higher. Collateralized mortgage obligations, including approximately $76 million secured by “ALT-A” mortgages, represented the remaining $103 million of residential mortgage-backed securities, of which 62% have credit ratings of A or better and 38% are BBB and below. For a discussion of changes in the fair value of our trading account assets supporting insurance liabilities see “—Experience-Rated Contractholder Liabilities, Trading Account Assets Supporting Insurance Liabilities and Other Related Investments,” above.

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The following table sets forth the composition of the corporate securities included in our trading account assets supporting insurance liabilities portfolio, by industry category, as of the dates indicated.

Corporate Securities by Industry Category—Trading Account Assets Supporting Insurance Liabilities

	September 30, 2012		December 31, 2011(2)	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
		(in millions)		
Industry(1)				
Corporate Securities:				
Finance	$ 2,380	$ 2,538	$ 2,021	$ 2,057
Consumer non-cyclical	1,989	2,184	1,785	1,946
Utility	1,384	1,549	1,382	1,521
Capital goods	1,185	1,299	812	871
Consumer cyclical	812	885	595	641
Energy	741	819	650	721
Basic industry	682	741	653	706
Communications	593	681	662	721
Transportation	432	463	565	599
Technology	364	406	474	515
Industrial other	359	381	669	712
Foreign agencies	201	207	101	103
Total Corporate Securities	$ 11,122	$ 12,153	$ 10,369	$ 11,113

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

(2) Prior period’s amounts are presented on a basis consistent with the current period presentation.

The following tables set forth our asset-backed securities included in our trading account assets supporting insurance liabilities portfolio as of the dates indicated, by credit quality, and for asset-backed securities collateralized by sub-prime mortgages, by year of issuance (vintage).

Asset-Backed Securities at Amortized Cost—Trading Account Assets Supporting Insurance Liabilities

	September 30, 2012 Lowest Rating Agency Rating						
	AAA	AA	A	BBB	BB and below	Total Amortized Cost	Total December 31, 2011
				(in millions)			
Vintage							
Collateralized by sub-prime mortgages:							
2012—2008	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
2007	0	0	0	0	116	116	120
2006	0	0	0	0	68	68	80
2005	0	0	0	0	32	32	35

2004 & Prior	0	7	6	0	46	59	65
Total collateralized by sub-prime mortgages	0	7	6	0	262	275	300
Other asset-backed securities:							
Collateralized by auto loans	246	0	0	0	0	246	292
Collateralized by credit cards	231	13	0	25	0	269	449
Other asset-backed securities	230	176	27	1	3	437	463
Total asset-backed securities	$ 707	$ 196	$ 33	$ 26	$ 265	$ 1,227	$ 1,504

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Asset-Backed Securities at Fair Value—Trading Account Assets Supporting Insurance Liabilities

Vintage	September 30, 2012 Lowest Rating Agency Rating AAA	AA	A	BBB (in millions)	BB and below	Total Fair Value	Total December 31, 2011
Collateralized by sub-prime mortgages:							
2012—2008	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
2007	0	0	0	0	63	63	42
2006	0	0	0	0	43	43	46
2005	0	0	0	0	24	24	25
2004 & Prior	0	6	5	0	35	46	44
Total collateralized by sub-prime mortgages(1)	0	6	5	0	165	176	157
Other asset-backed securities:							
Collateralized by auto loans	249	0	0	0	0	249	293
Collateralized by credit cards	240	13	0	25	0	278	461
Other asset-backed securities(2)	232	183	28	1	3	447	456
Total asset-backed securities	$ 721	$ 202	$ 33	$ 26	$ 168	$ 1,150	$ 1,367

(1) No securities collateralized by second-lien exposures were included within the $176 million of asset-backed securities collateralized by sub-prime mortgages at fair value as of September 30, 2012.

(2) As of September 30, 2012, includes collateralized debt obligations with fair value of $13 million, none of which is secured by sub-prime mortgages. Also includes asset-backed securities collateralized by education loans, franchises, timeshares, and equipment leases.

The following tables set forth our commercial mortgage-backed securities included in our trading account assets supporting insurance liabilities portfolio as of the dates indicated, by credit quality and by year of issuance (vintage).

Commercial Mortgage-Backed Securities at Amortized Cost—Trading Account Assets Supporting Insurance Liabilities

Vintage	September 30, 2012 Lowest Rating Agency Rating AAA	AA	A	BBB (in millions)	BB and below	Total Amortized Cost	Total December 31, 2011
2012	$ 42	$ 0	$ 0	$ 0	$ 0	$ 42	$ 0
2011	16	10	0	0	0	26	26
2010	0	103	0	0	0	103	103
2009	0	5	0	0	0	5	4
2008	30	0	0	0	0	30	30
2007	161	0	0	0	0	161	195
2006	645	11	0	0	0	656	631
2005 & Prior	887	4	18	8	11	928	1,168

Total commercial mortgage-backed securities(1)	$ 1,781	$ 133	$ 18	$ 8	$ 11	$ 1,951	$ 2,157

(1) Included in the table above as of September 30, 2012, are downgraded super senior securities with amortized cost of $11 million in AA.

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Commercial Mortgage-Backed Securities at Fair Value—Trading Account Assets Supporting Insurance Liabilities

	September 30, 2012 Lowest Rating Agency Rating						
	AAA	AA	A	BBB (in millions)	BB and below	Total Fair Value	Total December 31, 2011
Vintage							
2012	$ 45	$ 0	$ 0	$ 0	$ 0	$ 45	$ 0
2011	18	11	0	0	0	29	28
2010	0	114	0	0	0	114	111
2009	0	5	0	0	0	5	5
2008	31	0	0	0	0	31	31
2007	166	0	0	0	0	166	198
2006	699	11	0	0	0	710	662
2005 & Prior	952	5	19	8	11	995	1,212
Total commercial mortgage-backed securities	$ 1,911	$ 146	$ 19	$ 8	$ 11	$ 2,095	$ 2,247

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

Public Fixed Maturity Securities—Trading Account Assets Supporting Insurance Liabilities

(1)(2)	September 30, 2012				December 31, 2011			
NAIC Designation	Amortized Cost	Gross Unrealized Gains(3)	Gross Unrealized Losses(3)	Fair Value (in millions)	Amortized Cost	Gross Unrealized Gains(3)	Gross Unrealized Losses(3)	Fair Value
1	$ 9,357	$ 693	$ 39	$ 10,011	$ 8,892	$ 472	$ 92	$ 9,272
2	2,483	315	10	2,788	2,560	217	15	2,762
Subtotal High or Highest Quality Securities	11,840	1,008	49	12,799	11,452	689	107	12,034
3	205	9	8	206	283	11	9	285
4	133	5	27	111	163	2	49	116
5	59	0	22	37	77	1	33	45
6	83	0	49	34	82	0	50	32
Subtotal Other Securities	480	14	106	388	605	14	141	478
Total Public Fixed Maturities	$ 12,320	$ 1,022	$ 155	$ 13,187	$ 12,057	$ 703	$ 248	$ 12,512

(1) See “—Fixed Maturity Securities Credit Quality” above for a discussion on NAIC Designations.
(2) Reflects equivalent ratings for investments of our international insurance operations that are not rated by U.S. insurance regulatory authorities.
(3) Amounts are reported in “Asset management fees and other income.”

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

Private Fixed Maturity Securities—Trading Account Assets Supporting Insurance Liabilities

(1)(2) NAIC Designation	September 30, 2012 Amortized Cost	Gross Unrealized Gains(3)	Gross Unrealized Losses(3)	Fair Value	December 31, 2011 Amortized Cost	Gross Unrealized Gains(3)	Gross Unrealized Losses(3)	Fair Value
				(in millions)				
1	$ 791	$ 76	$ 0	$ 867	$ 828	$ 74	$ 10	$ 892
2	3,320	275	2	3,593	3,143	262	13	3,392
Subtotal High or Highest Quality Securities	4,111	351	2	4,460	3,971	336	23	4,284
3	588	39	3	624	588	33	2	619
4	159	4	2	161	123	3	5	121
5	56	1	1	56	76	0	4	72
6	9	0	8	1	13	0	2	11
Subtotal Other Securities	812	44	14	842	800	36	13	823
Total Private Fixed Maturities	$ 4,923	$ 395	$ 16	$ 5,302	$ 4,771	$ 372	$ 36	$ 5,107

(1) See “—Fixed Maturity Securities Credit Quality” above for a discussion on NAIC Designations.
(2) Reflects equivalent ratings for investments of our international insurance operations that are not rated by U.S. insurance regulatory authorities.
(3) Amounts are reported in “Asset management fees and other income.”

Other Trading Account Assets

Other trading account assets consist primarily of certain financial instruments that contain an embedded derivative where we elected to classify the entire instrument as a trading account asset rather than bifurcate. These instruments are carried at fair value, with realized and unrealized gains and losses reported in “Asset management fees and other income,” and excluded from adjusted operating income. Interest and dividend income from these investments is reported in “Net investment income,” and is included in adjusted operating income.

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The following table sets forth the composition of our other trading account assets as of the dates indicated.

	September 30, 2012				December 31, 2011			
	Financial Services Businesses		Closed Block Business		Financial Services Businesses		Closed Block Business	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(in millions)							
Short-term investments and cash equivalents	$ 1	$ 1	$ 0	$ 0	$ 4	$ 4	$ 0	$ 0
Fixed maturities:								
Corporate securities	93	89	110	120	116	104	110	119
Commercial mortgage-backed	120	90	0	0	155	111	0	0
Residential mortgage-backed	0	0	0	0	186	96	0	0
Asset-backed securities	399	298	16	16	598	551	69	70
Foreign government	48	49	0	0	46	46	0	0
U.S. government	4	4	0	0	4	4	0	0
Total fixed maturities	664	530	126	136	1,105	912	179	189
Equity securities(1)	1,113	1,122	119	128	1,226	1,177	133	128
Other	0	0	0	0	11	11	0	0
Total other trading account assets	$ 1,778	$ 1,653	$ 245	$ 264	$ 2,346	$ 2,104	$ 312	$ 317

(1) Included in equity securities are perpetual preferred stock securities that have characteristics of both debt and equity securities.

As of September 30, 2012, on an amortized cost basis, 74% of asset-backed securities classified as “Other trading account assets” attributable to the Financial Services Businesses have credit ratings of A or above, 14% have BBB credit ratings, and the remaining 12% have BB or below credit ratings. As of September 30, 2012, on an amortized cost basis, 100% of asset-backed securities classified as “Other trading account assets” attributable to the Closed Block Business have credit ratings of A or above.

Commercial Mortgage and Other Loans

Investment Mix

As of both September 30, 2012 and December 31, 2011, we held approximately 10% of our general account investments in commercial mortgage and other loans. This percentage is net of a $282 million and $310 million allowance for losses as of September 30, 2012 and December 31, 2011, respectively.

The following table sets forth the composition of our commercial mortgage and other loans portfolio, before the allowance for losses, as of the dates indicated.

	September 30, 2012		December 31, 2011	
	Financial Services Businesses	Closed Block Business	Financial Services Businesses	Closed Block Business
	(in millions)			
Commercial and agricultural mortgage loans	$ 23,679	$ 9,821	$ 21,988	$ 9,100
Uncollateralized loans	1,938	0	2,236	0
Residential property loans	900	0	1,033	0
Other collateralized loans	53	0	66	0
Total commercial mortgage and other loans(1)	$ 26,570	$ 9,821	$ 25,323	$ 9,100

(1) Excluded from the table above are commercial mortgage loans held outside the general account in other entities and operations. For additional information regarding commercial mortgage loans held outside the general account, see “—Invested Assets of Other Entities and Operations” below.

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We originate commercial and agricultural mortgage loans using a dedicated investment staff and a network of independent companies through our various regional offices. All loans are underwritten consistently to our standards using a proprietary quality rating system that has been developed from our experience in real estate and mortgage lending.

Uncollateralized loans primarily represent reverse dual currency loans and corporate loans which do not meet the definition of a security under authoritative accounting guidance.

Residential property loans primarily include Japanese recourse loans. Upon default of these recourse loans we can make a claim against the personal assets of the property owner, in addition to the mortgaged property. These loans are also backed by third party guarantors.

Other collateralized loans attributable to the Financial Services Businesses include $51 million and $63 million of collateralized consumer loans as of September 30, 2012 and December 31, 2011, respectively.

Composition of Commercial and Agricultural Mortgage Loans

The commercial real estate market was severely impacted by the financial crisis and the subsequent recession, though the flow of capital to commercial real estate has been strong since 2010. Portfolio lenders are actively originating loans on the highest quality properties in primary markets, resulting in an increase in the liquidity and availability of capital in the commercial mortgage loan market. For certain property types, the market fundamentals are stabilizing to slightly improving, while other property types have farther to go in this recovery. In addition, the commercial banks are active and there has been new loan origination activity by securitization lenders. These conditions have led to greater competition for portfolio lenders such as our general account, though underwriting remains conservative. While there is still weakness in commercial real estate fundamentals that are dependent on employment recovery, delinquency rates on our commercial mortgage loans remain relatively stable. For additional information see “—Realized Investment Gains and Losses.”

Our commercial and agricultural mortgage loan portfolio strategy emphasizes diversification by property type and geographic location. The following tables set forth the breakdown of the gross carrying values of our general account investments in commercial and agricultural mortgage loans by geographic region and property type as of the dates indicated.

	September 30, 2012				December 31, 2011			
	Financial Services Businesses		Closed Block Business		Financial Services Businesses		Closed Block Business	
	Gross Carrying Value	% of Total	Gross Carrying Value	% of Total	Gross Carrying Value	% of Total	Gross Carrying Value	% of Total
	($ in millions)							
Commercial and agricultural mortgage loans by region:								
U.S. Regions:								
Pacific	$ 7,406	31.3%	$ 3,326	33.9%	$ 7,136	32.5%	$ 3,118	34.3%
South Atlantic	4,811	20.3	1,947	19.8	4,568	20.8	1,868	20.5
Middle Atlantic	3,567	15.1	2,139	21.8	3,221	14.6	2,109	23.2
East North Central	1,905	8.0	560	5.7	1,579	7.2	336	3.7
West South Central	2,149	9.1	735	7.5	1,858	8.4	688	7.6

Mountain	1,171	4.9	372	3.8	1,181	5.4	356	3.9
New England	689	2.9	322	3.3	637	2.9	257	2.8
West North Central	474	2.0	163	1.6	576	2.6	185	2.0
East South Central	359	1.5	152	1.5	307	1.4	152	1.7
Subtotal-U.S.	22,531	95.1	9,716	98.9	21,063	95.8	9,069	99.7
Asia	700	3.0	0	0.0	519	2.4	0	0.0
Other	448	1.9	105	1.1	406	1.8	31	0.3
Total commercial and agricultural mortgage loans	$ 23,679	100.0%	$ 9,821	100.0%	$ 21,988	100.0%	$ 9,100	100.0%

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	September 30, 2012				December 31, 2011			
	Financial Services Businesses		Closed Block Business		Financial Services Businesses		Closed Block Business	
	Gross Carrying Value	% of Total	Gross Carrying Value	% of Total	Gross Carrying Value	% of Total	Gross Carrying Value	% of Total
	($ in millions)							
Commercial and agricultural mortgage loans by property type:								
Industrial	$ 5,643	23.8%	$ 1,850	18.9%	$ 5,234	23.8%	$ 1,804	19.8%
Retail	5,420	22.9	2,662	27.1	4,988	22.7	2,207	24.2
Office	4,291	18.1	2,288	23.3	4,043	18.4	2,216	24.4
Apartments/Multi-Family	3,769	15.9	1,252	12.7	3,263	14.8	1,254	13.8
Other	2,114	8.9	577	5.9	2,079	9.5	517	5.7
Agricultural properties	1,458	6.2	702	7.1	1,363	6.2	674	7.4
Hospitality	984	4.2	490	5.0	1,018	4.6	428	4.7
Total commercial and agricultural mortgage loans	$ 23,679	100.0%	$ 9,821	100.0%	$ 21,988	100.0%	$ 9,100	100.0%

Loan-to-value and debt service coverage ratios are measures commonly used to assess the quality of commercial and agricultural mortgage loans. The loan-to-value ratio compares the amount of the loan to the fair value of the underlying property collateralizing the loan, and is commonly expressed as a percentage. Loan-to-value ratios greater than 100% percent indicate that the loan amount is greater than the collateral value. A smaller loan-to-value ratio indicates a greater excess of collateral value over the loan amount. The debt service coverage ratio compares a property’s net operating income to its debt service payments. Debt service coverage ratios less than 1.0 times indicate that property operations do not generate enough income to cover the loan’s current debt payments. A larger debt service coverage ratio indicates a greater excess of net operating income over the debt service payments.

As of September 30, 2012, our general account investments in commercial and agricultural mortgage loans attributable to the Financial Services Businesses had a weighted average debt service coverage ratio of 2.02 times, and a weighted average loan-to-value ratio of 58%. As of September 30, 2012, approximately 98% of commercial and agricultural mortgage loans attributable to the Financial Services Businesses were fixed rate loans. As of September 30, 2012, our general account investments in commercial and agricultural mortgage loans attributable to the Closed Block Business had a weighted average debt service coverage ratio of 2.0 times and a weighted average loan-to-value ratio of 54%. As of September 30, 2012, approximately 99% of commercial and agricultural mortgage loans attributable to the Closed Block Business were fixed rate loans. For those general account commercial and agricultural mortgage loans attributable to the Financial Services Businesses that were originated in 2012, the weighted average debt service coverage ratio was 2.47 times and the weighted average loan-to-value ratio was 63%.

The values utilized in calculating these loan-to-value ratios are developed as part of our periodic review of the commercial and agricultural mortgage loan portfolio, which includes an internal evaluation of the underlying collateral value. Our periodic review also includes a quality re-rating process, whereby we update the internal quality rating originally assigned at underwriting based on the proprietary quality rating system mentioned above. As discussed below, the internal quality rating is a key input in determining our allowance for loan losses.

For loans with collateral under construction, renovation or lease-up, a stabilized value and projected net operating income are used in the calculation of the loan-to-value and debt service coverage ratios. Our commercial and agricultural mortgage loan portfolio attributable to the Financial Services Businesses included approximately $0.5 billion of such loans as of both September 30, 2012 and December 31, 2011, and our commercial and agricultural mortgage loan portfolio attributable to the Closed Block Business included approximately $0.1 billion and $0.2 billion of such loans as of September 30, 2012 and December 31, 2011, respectively. All else being equal, these loans are inherently more risky than those collateralized by properties that have already stabilized. As of September 30, 2012, there are no loan-specific reserves related to these loans attributable to the Financial Services Businesses or the Closed Block Business. In addition, these unstabilized loans are included in the calculation of our portfolio reserve as discussed below. For information regarding similar loans we hold as part of our commercial and agricultural mortgage operations, see “—Invested Assets of Other Entities and Operations.”

The following tables set forth the gross carrying value of our general account investments in commercial and agricultural mortgage loans attributable to the Financial Services Businesses and the Closed Block Business as of the dates indicated by loan-to-value and debt service coverage ratios.

Commercial and Agricultural Mortgage Loans by Loan-to-Value and Debt Service Coverage Ratios—Financial Services Businesses

	September 30, 2012 Debt Service Coverage Ratio						
Loan-to-Value Ratio	Greater than 2.0x	1.8x to 2.0x	1.5x to < 1.8x	1.2x to < 1.5x (in millions)	1.0x to < 1.2x	Less than 1.0x	Total Commercial and Agricultural Mortgage Loans
0%-49.99%	$ 3,834	$ 1,308	$ 1,022	$ 870	$ 261	$ 68	$ 7,363
50%-59.99%	1,666	825	966	562	80	139	4,238
60%-69.99%	2,880	878	1,441	1,424	525	131	7,279
70%-79.99%	914	362	504	971	457	141	3,349
80%-89.99%	20	0	19	246	268	413	966
90%-100%	0	0	68	0	46	178	292
Greater than 100%	0	0	19	28	2	143	192
Total commercial and agricultural mortgage loans	$ 9,314	$ 3,373	$ 4,039	$ 4,101	$ 1,639	$ 1,213	$ 23,679

Commercial and Agricultural Mortgage Loans by Loan-to-Value and Debt Service Coverage Ratios—Closed Block Business

	September 30, 2012 Debt Service Coverage Ratio						
Loan-to-Value Ratio	Greater than 2.0x	1.8x to 2.0x	1.5x to < 1.8x	1.2x to < 1.5x (in millions)	1.0x to < 1.2x	Less than 1.0x	Total Commercial and Agricultural Mortgage Loans
0%-49.99%	$ 1,896	$ 522	$ 492	$ 398	$ 167	$ 20	$ 3,495
50%-59.99%	682	349	558	335	29	48	2,001
60%-69.99%	874	265	746	827	209	9	2,930
70%-79.99%	267	163	189	203	156	53	1,031
80%-89.99%	0	0	0	62	127	115	304

90%-100%	0	0	0	0	0	45	45
Greater than 100%	0	0	0	0	5	10	15
Total commercial and agricultural mortgage loans	$ 3,719	$ 1,299	$ 1,985	$ 1,825	$ 693	$ 300	$ 9,821

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The following table sets forth the breakdown of our commercial and agricultural mortgage loans by year of origination as of September 30, 2012.

	September 30, 2012			
	Financial Services Businesses		Closed Block Business	
Year of Origination	Gross Carrying Value	% of Total	Gross Carrying Value	% of Total
	($ in millions)			
2012	$ 3,591	15.2%	$ 1,582	16.1%
2011	4,891	20.6	1,454	14.8
2010	3,165	13.4	1,075	10.9
2009	1,278	5.4	448	4.6
2008	2,622	11.1	1,091	11.1
2007 & prior	8,132	34.3	4,171	42.5
Total commercial and agricultural mortgage loans	$ 23,679	100.0%	$ 9,821	100.0%

Commercial Mortgage and Other Loan Quality

Ongoing review of the portfolio is performed and loans are placed on watch list status based on a predefined set of criteria, where they are assigned to one of the following categories. We place loans on early warning status in cases where, based on our analysis of the loan’s collateral, the financial situation of the borrower or tenants or other market factors, we believe a loss of principal or interest could occur. We classify loans as closely monitored when we determine there is a collateral deficiency or other credit events that may lead to a potential loss of principal or interest. Loans not in good standing are those loans where we have concluded that there is a high probability of loss of principal, such as when the loan is in the process of foreclosure or the borrower is in bankruptcy. In our domestic operations, our workout and special servicing professionals manage the loans on the watch list. As described below, in determining our allowance for losses we evaluate each loan on the watch list to determine if it is probable that amounts due according to the contractual terms of the loan agreement will not be collected. In our international portfolios, we monitor delinquency in consumer loans on a pool basis and evaluate any servicing relationship and guarantees the same way we do for commercial mortgage loans.

We establish an allowance for losses to provide for the risk of credit losses inherent in the lending process. The allowance includes loan specific reserves for loans that are determined to be impaired as a result of our loan review process, and a portfolio reserve for probable incurred but not specifically identified losses for loans which are not on the watch list. We define an impaired loan as a loan for which we estimate it is probable that amounts due according to the contractual terms of the loan agreement will not be collected. The loan specific portion of the loss allowance is based on our assessment as to ultimate collectability of loan principal and interest. Valuation allowances for an impaired loan are recorded based on the present value of expected future cash flows discounted at the loan’s effective interest rate or based on the fair value of the collateral if the loan is collateral dependent. The portfolio reserve for incurred but not specifically identified losses considers the current credit composition of the portfolio based on the internal quality ratings mentioned above. The portfolio reserves are determined using past loan experience, including historical credit migration, loss probability, and loss severity factors by property type. These factors are reviewed and updated as appropriate. The valuation allowance for commercial mortgage and other loans can increase or decrease from period to period based on these factors.

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The following tables set forth the aging schedule of our general account investments in commercial mortgage and other loans, based upon the recorded investment gross of allowance for credit losses, attributable to the Financial Services Businesses and Closed Block Business as of the dates indicated.

Commercial Mortgage and Other Loans—Financial Services Businesses

	September 30, 2012						
	Current	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days- Accruing (in millions)	Greater Than 90 Days-Not Accruing	Total Past Due	Total Commercial Mortgage and Other Loans
Commercial mortgage loans:							
Industrial	$ 5,643	$ 0	$ 0	$ 0	$ 0	$ 0	$ 5,643
Retail	5,413	2	0	0	5	7	5,420
Office	4,286	5	0	0	0	5	4,291
Apartments/Multi-Family	3,768	1	0	0	0	1	3,769
Hospitality	984	0	0	0	0	0	984
Other	2,105	4	0	0	5	9	2,114
Total commercial mortgage loans	22,199	12	0	0	10	22	22,221
Agricultural property loans	1,422	0	0	0	36	36	1,458
Residential property loans	867	11	5	0	17	33	900
Other collateralized loans	53	0	0	0	0	0	53
Uncollateralized loans	1,938	0	0	0	0	0	1,938
Total	$ 26,479	$ 23	$ 5	$ 0	$ 63	$ 91	$ 26,570

Commercial Mortgage and Other Loans—Closed Block Business

	September 30, 2012						
	Current	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days- Accruing (in millions)	Greater Than 90 Days-Not Accruing	Total Past Due	Total Commercial Mortgage and Other Loans
Commercial mortgage loans:							
Industrial	$ 1,850	$ 0	$ 0	$ 0	$ 0	$ 0	$ 1,850
Retail	2,662	0	0	0	0	0	2,662
Office	2,288	0	0	0	0	0	2,288
Apartments/Multi-Family	1,252	0	0	0	0	0	1,252
Hospitality	490	0	0	0	0	0	490
Other	577	0	0	0	0	0	577
Total commercial mortgage loans	9,119	0	0	0	0	0	9,119
Agricultural property loans	702	0	0	0	0	0	702

Residential property loans	0	0	0	0	0	0	0
Other collateralized loans	0	0	0	0	0	0	0
Uncollateralized loans	0	0	0	0	0	0	0
Total	$ 9,821	$ 0	$ 0	$ 0	$ 0	$ 0	$ 9,821

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Commercial Mortgage and Other Loans—Financial Services Businesses

	December 31, 2011						
	Current	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days-Accruing	Greater Than 90 Days-Not Accruing	Total Past Due	Total Commercial Mortgage and Other Loans
	(in millions)						
Commercial mortgage loans:							
Industrial	$ 5,234	$ 0	$ 0	$ 0	$ 0	$ 0	$ 5,234
Retail	4,983	0	0	0	5	5	4,988
Office	4,022	5	0	0	16	21	4,043
Apartments/Multi-Family	3,217	0	0	0	46	46	3,263
Hospitality	1,018	0	0	0	0	0	1,018
Other	2,029	13	10	0	27	50	2,079
Total commercial mortgage loans	20,503	18	10	0	94	122	20,625
Agricultural property loans	1,331	1	1	0	30	32	1,363
Residential property loans	987	22	6	0	18	46	1,033
Other collateralized loans	66	0	0	0	0	0	66
Uncollateralized loans	2,236	0	0	0	0	0	2,236
Total	$ 25,123	$ 41	$ 17	$ 0	$ 142	$ 200	$ 25,323

Commercial Mortgage and Other Loans—Closed Block Business

	December 31, 2011						
	Current	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days-Accruing	Greater Than 90 Days-Not Accruing	Total Past Due	Total Commercial Mortgage and Other Loans
	(in millions)						
Commercial mortgage loans:							
Industrial	$ 1,802	$ 0	$ 2	$ 0	$ 0	$ 2	$ 1,804
Retail	2,207	0	0	0	0	0	2,207
Office	2,216	0	0	0	0	0	2,216
Apartments/Multi-Family	1,254	0	0	0	0	0	1,254
Hospitality	428	0	0	0	0	0	428
Other	517	0	0	0	0	0	517
Total commercial mortgage loans	8,424	0	2	0	0	2	8,426
Agricultural property loans	674	0	0	0	0	0	674
Residential property loans	0	0	0	0	0	0	0
Other collateralized loans	0	0	0	0	0	0	0
Uncollateralized loans	0	0	0	0	0	0	0
Total	$ 9,098	$ 0	$ 2	$ 0	$ 0	$ 2	$ 9,100

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

	September 30, 2012		December 31, 2011	
	Financial Services Businesses	Closed Block Business	Financial Services Businesses	Closed Block Business
	(in millions)			
Allowance, beginning of year	$ 250	$ 60	$ 333	$ 102
Addition to/(release of) allowance for losses	(4)	(4)	(71)	(34)
Charge-offs, net of recoveries	(19)	0	(15)	(8)
Change in foreign exchange	(1)	0	3	0
Allowance, end of period	$ 226	$ 56	$ 250	$ 60

As of September 30, 2012, the $226 million valuation allowance for our commercial mortgage and other loan portfolio attributable to the Financial Services Businesses included $75 million related to loan specific reserves and $151 million related to the portfolio reserve for probable incurred but not specifically identified losses. As of December 31, 2011, the $250 million valuation allowance for our commercial mortgage and other loan portfolio attributable to the Financial Services Businesses included $91 million related to loan specific reserves and $159 million related to the portfolio reserve for probable incurred but not specifically identified losses.

As of September 30, 2012, the $56 million valuation allowance for our commercial mortgage and other loan portfolio attributable to the Closed Block Business included $4 million related to loan specific reserves and $52 million related to the portfolio reserve for probable incurred but not specifically identified losses. As of December 31, 2011, the $60 million valuation allowance for our commercial mortgage and other loan portfolio attributable to the Closed Block Business included $2 million related to loan specific reserves and $58 million related to the portfolio reserve for probable incurred but not specifically identified losses. The decrease in the allowance for both the Financial Services Businesses and the Closed Block Business primarily reflects positive credit migration for certain mortgages.

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Equity Securities

Investment Mix

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

Equity Securities—Financial Services Businesses

	September 30, 2012				December 31, 2011			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in millions)							
Public Equity								
Non-redeemable preferred stocks	$ 1	$ 1	$ 0	$ 2	$ 1	$ 1	$ 0	$ 2
Mutual fund common stocks(1)	1,841	488	0	2,329	1,708	428	2	2,134
Other common stocks	2,338	171	110	2,399	2,400	75	272	2,203
Total public equity	4,180	660	110	4,730	4,109	504	274	4,339
Private Equity								
Non-redeemable preferred stocks	16	1	0	17	18	0	1	17
Common stock	46	18	3	61	28	17	0	45
Total private equity(2)	62	19	3	78	46	17	1	62
Total equity	$ 4,242	$ 679	$ 113	$ 4,808	$ 4,155	$ 521	$ 275	$ 4,401

(1) Includes mutual fund shares representing our interest in the underlying assets of certain of our separate account investments supporting corporate-owned life insurance. These mutual funds invest primarily in high yield bonds.
(2) Hedge funds and other alternative investments are included in “Other long-term investments.”

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

Equity Securities—Closed Block Business

	September 30, 2012	December 31, 2011
	Cost	Cost

		Gross Unrealized Gains	Gross Unrealized Losses	Fair Value		Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
				(in millions)				
Public Equity								
Non-redeemable preferred stocks	$ 3	$ 0	$ 0	$ 3	$ 2	$ 0	$ 0	$ 2
Common stock	2,407	778	26	3,159	2,746	538	173	3,111
Total public equity	2,410	778	26	3,162	2,748	538	173	3,113
Private Equity								
Non-redeemable preferred stocks	8	1	0	9	9	0	0	9
Common stock	0	0	0	0	0	0	0	0
Total private equity	8	1	0	9	9	0	0	9
Total equity	$ 2,418	$ 779	$ 26	$ 3,171	$ 2,757	$ 538	$ 173	$ 3,122

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Unrealized Losses from Equity Securities

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

Unrealized Losses from Equity Securities, Less than 20%—Financial Services Businesses

	September 30, 2012		December 31, 2011	
	Amortized Cost(1)	Gross Unrealized Losses(1)	Amortized Cost(1)	Gross Unrealized Losses(1)
	(in millions)			
Less than three months	$ 384	$ 17	$ 508	$ 31
Three months or greater but less than six months	248	25	551	54
Six months or greater but less than nine months	109	7	191	24
Nine months or greater but less than twelve months	52	7	193	35
Greater than twelve months	2	0	0	0
Total	$ 795	$ 56	$ 1,443	$ 144

(1) The aging of amortized cost and gross unrealized losses is determined based upon a count of the number of months the estimated fair value remained below cost by less than 20%, using month-end valuations.

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

Unrealized Losses from Equity Securities, Greater than 20%—Financial Services Businesses

	September 30, 2012		December 31, 2011	
	Amortized Cost(1)	Gross Unrealized Losses(1)	Amortized Cost(1)	Gross Unrealized Losses(1)
	(in millions)			
Less than three months	$ 193	$ 52	$ 243	$ 63
Three months or greater but less than six months	6	2	172	60
Six months or greater but less than nine months	6	3	20	8
Nine months or greater but less than twelve months	0	0	0	0
Greater than twelve months	0	0	0	0
Total	$ 205	$ 57	$ 435	$ 131

(1) The aging of amortized cost and gross unrealized losses is determined based upon a count of the number of months the estimated fair value remained below cost by 20% or more, using month-end valuations.

The gross unrealized losses as of September 30, 2012, were primarily concentrated in the consumer cyclical, technology and finance sectors compared to December 31, 2011, where the gross unrealized losses were primarily concentrated in the finance, basic industry, and industrial other sectors. Gross unrealized losses attributable to the Financial Services Businesses where the estimated fair value had declined and remained below cost by 20% or more was $57 million as of September 30, 2012 and does not include any gross unrealized losses on securities where the estimated fair value had declined and remained below cost by 50% or more. We have not recognized the gross unrealized losses shown in the table above as other-than-temporary impairments. See “—Other-Than-Temporary Impairments of Equity Securities” for a discussion of the factors we consider in making these determinations.

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

Unrealized Losses from Equity Securities, Less than 20%—Closed Block Business

	September 30, 2012		December 31, 2011	
	Amortized Cost(1)	Gross Unrealized Losses(1)	Amortized Cost(1)	Gross Unrealized Losses(1)
	(in millions)			
Less than three months	$ 272	$ 10	$ 377	$ 23
Three months or greater but less than six months	83	5	287	28
Six months or greater but less than nine months	49	4	151	14
Nine months or greater but less than twelve months	6	1	18	3
Greater than twelve months	0	0	0	0
Total	$ 410	$ 20	$ 833	$ 68

(1) The aging of amortized cost and gross unrealized losses is determined based upon a count of the number of months the estimated fair value remained below cost by less than 20%, using month-end valuations.

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

Unrealized Losses from Equity Securities, Greater than 20%—Closed Block Business

	September 30, 2012		December 31, 2011	
	Amortized Cost(1)	Gross Unrealized Losses(1)	Amortized Cost(1)	Gross Unrealized Losses(1)
	(in millions)			
Less than three months	$ 8	$ 2	$ 164	$ 43
Three months or greater but less than six months	9	3	166	59
Six months or greater but less than nine months	3	1	8	3
Nine months or greater but less than twelve months	0	0	0	0
Greater than twelve months	0	0	0	0
Total	$ 20	$ 6	$ 338	$ 105

(1) The aging of amortized cost and gross unrealized losses is determined based upon a count of the number of months the estimated fair value remained below cost by 20% or more, using month-end valuations.

The gross unrealized losses as of September 30, 2012, were primarily concentrated in the basic industry sector compared to December 31, 2011, where the gross unrealized losses were primarily concentrated in the finance, basic industry, and consumer non-cyclical sectors. Gross unrealized losses attributable to the Closed Block Business where the estimated fair value had declined and remained below cost by 20% or more of $6 million as of September 30, 2012 and does not include any gross unrealized losses on securities where the estimated fair value had declined and remained below cost by 50% or more. We have not recognized the gross unrealized losses shown in the table above as other-than-temporary impairments. See “—Other-Than-Temporary Impairments of Equity Securities” for a discussion of the factors we consider in making these determinations.

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Other-Than-Temporary Impairments of Equity Securities

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

- • the extent and the duration of the decline; including, but not limited to, the following general guidelines:
  - • declines in value greater than 20%, maintained for six months or greater;
  - • declines in value maintained for one year or greater; and
  - • declines in value greater than 50%;
- • the reasons for the decline in value (issuer specific event, currency or market fluctuation);
- • our ability and intent to hold the investment for a period of time to allow for a recovery of value, including certain equity securities managed by independent third parties where we do not exercise management discretion concerning individual buy or sell decisions; and
- • the financial condition of and near-term prospects of the issuer.

We generally recognize other-than-temporary impairments for securities with declines in value greater than 50% maintained for six months or greater or with any decline in value maintained for one year or greater. In addition, in making our determinations we continue to analyze the financial condition and near-term prospects of the issuer, including an assessment of the issuer’s capital position, and consider our ability and intent to hold the investment for a period of time to allow for a recovery of value.

For those securities that have declines in value that are deemed to be only temporary, we make an assertion as to our ability and intent to retain the security until recovery. Once identified, these securities are restricted from trading unless authorized based upon events that could not have been foreseen at the time we asserted our ability and intent to retain the security until recovery. Examples of such events include, but are not limited to, the deterioration of the issuer’s creditworthiness, a major business combination or disposition, a change in regulatory requirements, certain other portfolio actions or other similar events. For those securities that have declines in value for which we cannot assert our ability and intent to retain until recovery, including certain equity securities managed by independent third parties where we do not exercise management discretion concerning individual buy or sell decisions, impairments are recognized as other-than-temporary regardless of the reason for, or the extent of, the decline. For perpetual preferred securities, which have characteristics of both debt and equity securities, we apply an impairment model similar to our fixed maturity securities, factoring in the position of the security in the capital structure and the lack of a formal maturity date. For additional discussion of our policies regarding other-than-temporary impairments of fixed maturity securities, see “—Fixed Maturity Securities—Other-than-Temporary Impairments of Fixed Maturity Securities” above.

When we determine that there is an other-than-temporary impairment, we record a writedown to estimated fair value, which reduces the cost basis and is included in “Realized investment gains (losses), net.” See Note 2 to the Unaudited Interim Consolidated Financial Statements for additional information regarding our policies around other-than-temporary impairments for equity securities. See Note 13 to the Unaudited Interim Consolidated Financial Statements for information regarding the fair value methodology used for equity securities.

Impairments of equity securities attributable to the Financial Services Businesses were $21 million and $40 million for the three months ended September 30, 2012, and 2011, respectively, and $93 million and $85 million for the nine months ended September 30, 2012, and 2011, respectively. Impairments of equity securities attributable to the Closed Block Business were $3 million and $2 million for the three months ended September 30, 2012, and 2011, respectively, and $21 million and $16 million for the nine months ended September 30, 2012, and 2011, respectively. For a further discussion of impairments, see “—Realized Investment Gains and Losses” above.

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Other Long-Term Investments

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

	September 30, 2012		December 31, 2011	
	Financial Services Businesses	Closed Block Business	Financial Services Businesses	Closed Block Business
	(in millions)			
Joint ventures and limited partnerships:				
Real estate-related	$ 340	$ 480	$ 360	$ 413
Non-real estate-related	1,840	1,390	1,733	1,284
Real estate held through direct ownership(1)	1,717	8	1,956	10
Other(2)	913	144	432	283
Total other long-term investments	$ 4,810	$ 2,022	$ 4,481	$ 1,990

(1) Primarily includes investments in office buildings within our Japanese insurance operations.
(2) Primarily includes derivatives and member and activity stock held in the Federal Home Loan Banks of New York and Boston. For additional information regarding our holdings in the Federal Home Loan Banks of New York and Boston, see Note 9 to the Unaudited Interim Consolidated Financial Statements.

Invested Assets of Other Entities and Operations

The following table sets forth the composition of the investments held outside the general account in other entities and operations as of the dates indicated.

	September 30, 2012	December 31, 2011
	(in millions)	
Fixed Maturities:		
Public, available-for-sale, at fair value	$ 446	$ 2,026
Private, available-for-sale, at fair value	89	82
Other trading account assets, at fair value	3,957	3,124
Equity securities, available-for-sale, at fair value	13	12
Commercial mortgage and other loans, at book value(1)	713	1,318
Other long-term investments	1,323	1,349
Short-term investments	3,288	2,984
Total investments	$ 9,829	$ 10,895

(1) Book value is generally based on unpaid principal balance net of any allowance for losses, the lower of cost or fair value, or fair value, depending on the loan.

The table above includes the invested assets of our trading, banking, and asset management operations. Assets of our asset management operations managed for third parties and those assets classified as “Separate account assets” on our balance sheet are not included.

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Fixed Maturity Securities

The following table sets forth the composition of the portion of our fixed maturity securities portfolio by industry category attributable to our other entities and operations as of the date indicated.

Fixed Maturity Securities—Invested Assets of Other Entities and Operations

	September 30, 2012						
	Lowest Rating Agency Rating					Total Amortized Cost	Total Fair Value
	AAA	AA	A	BBB	BB and below		
	(in millions)						
Industry(1)							
Residential mortgage-backed	$ 0	$ 178	$ 0	$ 0	$ 5	$ 183	$ 192
Asset-backed securities	8	20	1	18	21	68	76
Commercial mortgage-backed	41	19	0	15	5	80	82
Corporate securities	4	8	73	25	4	114	129
U.S. government	0	46	0	0	0	46	55
State & municipal	0	0	1	0	0	1	1
Foreign government	1	0	0	0	0	1	0
Total	$ 54	$ 271	$ 75	$ 58	$ 35	$ 493	$ 535

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

The table above includes the invested assets of our trading, banking, and asset management operations. Assets of our asset management operations managed for third parties and those assets classified as “Separate account assets” on our balance sheet are not included.

Other Trading Account Assets

Other trading account assets primarily include trading positions held by our derivatives trading operations used in a non-dealer capacity. The positions maintained by our derivatives trading operations are used to manage interest rate, currency, credit and equity exposures in our insurance, investment and international businesses, and treasury operations.

Less than $1 million of commercial mortgage-backed securities held outside the general account are classified as other trading account assets as of September 30, 2012, all of which have AAA credit ratings.

Commercial Mortgage and Other Loans

Our asset management operations include our commercial mortgage operations, which provide mortgage origination, asset management and servicing for our general account, institutional clients, and government sponsored entities such as Fannie Mae, the Federal Housing Administration, and Freddie Mac. We also originate shorter-term interim loans for spread lending that are collateralized by assets generally under renovation or lease-up. All else being equal, these interim loans are inherently more risky than those collateralized by properties that have already stabilized. Our interim loans are generally paid off through refinancing or the sale of the underlying collateral by the borrower.

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The following table sets forth information regarding the interim loan portfolio held outside the general account in other entities and operations as of the dates indicated.

	September 30, 2012	December 31, 2011
	($ in millions)	
Interim Loan Portfolio:		
Principal balance of loans outstanding	$ 422	$ 648
Allowance for credit or valuation-related losses	$ 25	$ 44
Weighted average loan-to-value ratio(1)	91%	93%
Weighted average debt service coverage ratio(1)	1.51	1.52

(1) A stabilized value and projected net operating income are used in the calculation of the loan-to-value and debt service coverage ratios.

As of September 30, 2012, we hold no commercial real estate held-for-sale related to foreclosed interim loans. The mortgage loans of our commercial mortgage operations are included in “Commercial mortgage and other loans,” with related derivatives and other hedging instruments primarily included in “Other trading account assets” and “Other long-term investments.”

Other Long-Term Investments

Other long-term investments primarily include strategic investments made as part of our asset management operations. We make these strategic investments in real estate, as well as fixed income, public equity and real estate securities, including controlling interests. Certain of these investments are made primarily for purposes of co-investment in our managed funds and structured products. Other strategic investments are made with the intention to sell or syndicate to investors, including our general account, or for placement in funds and structured products that we offer and manage (seed investments). As part of our asset management operations, we also make loans to our managed funds that are secured by equity commitments from investors or assets of the funds.

Liquidity and Capital Resources

Overview

Liquidity refers to the ability to generate sufficient cash resources to meet the payment obligations of the Company. Capital refers to the long term financial resources available to support the operation of our businesses, fund business growth, and provide a cushion to withstand adverse circumstances. Our ability to generate and maintain sufficient liquidity and capital depends on the profitability of our businesses, general economic conditions and our access to the capital markets and the alternate sources of liquidity and capital described herein.

Liquidity and Capital Management

Management monitors the liquidity of Prudential Financial and its subsidiaries on a daily basis and projects borrowing and capital needs over a multi-year time horizon through our quarterly planning process. We believe that cash flows from the sources of funds presently available to us are sufficient to satisfy the current liquidity requirements of Prudential Financial and its subsidiaries, including under reasonably foreseeable stress scenarios.

Our capital management framework is primarily based on statutory risk based capital measures. Due to our diverse mix of businesses and applicable regulatory requirements, we apply certain refinements to the framework that are designed to more appropriately reflect risks associated with our businesses on a consistent basis across the Company. In addition, we continue to use an economic capital framework for making certain capital decisions.

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Capital Protection Framework

We employ a “Capital Protection Framework” to ensure the availability of capital resources to maintain adequate capitalization on a consolidated basis and competitive risk based capital ratios and solvency margins for our insurance subsidiaries, including under reasonably foreseeable stress scenarios. The Capital Protection Framework incorporates the potential impact from market related stresses, including equity markets, interest rates, credit losses, and foreign currency exchange rates. Potential sources of capital include on-balance sheet capital and proceeds from derivatives, reinsurance and contingent sources of capital. Although we continue to enhance our approach, we believe we currently have sufficient resources to maintain adequate capitalization and competitive risk based capital ratios and solvency margins under reasonably foreseeable stress scenarios.

Regulation Under The Dodd-Frank Act

On October 19, 2012, Prudential Financial received notice that it is under consideration by the Financial Stability Oversight Council (the “Council”) for a proposed determination that it should be subject to stricter prudential regulatory standards and supervision by the Board of Governors of the Federal Reserve System pursuant to the Dodd-Frank Act (a “Covered Company”). The notice of consideration indicates that Prudential Financial is being reviewed in stage 3 of the three-stage process described in the Council’s interpretative guidance for Covered Company determinations and does not constitute a notice of a proposed determination. The prudential standards under the Dodd-Frank Act include requirements regarding risk-based capital and leverage, liquidity, stress-testing and other matters. See “Business—Regulation” and “Risk Factors” in our 2011 Annual Report on Form 10-K for more information regarding the potential impact of the Dodd-Frank Act on the Company, including as a result of these stricter prudential standards.

Shareholder Dividend

On November 7, 2012, Prudential Financial declared an annual dividend for 2012 of $1.60 per share of Common Stock, representing an increase of approximately 10% from the 2011 Common Stock dividend. The Company also announced that it will move to a quarterly Common Stock dividend schedule beginning in the first quarter of 2013.

Liquidity and Capital Resources of Prudential Financial

The principal sources of funds available to Prudential Financial, the parent holding company, are dividends, returns of capital and interest income from its subsidiaries, and cash and short-term investments. These sources of funds may be supplemented by Prudential Financial’s access to the capital markets and the “—Alternative Sources of Liquidity” described below.

The primary uses of funds at Prudential Financial include servicing our debt, operating expenses, capital contributions and other payments to subsidiaries, and the payment of declared shareholder dividends, as well as repurchases of outstanding shares of Common Stock if executed under Board authority.

As of September 30, 2012, Prudential Financial had cash and short-term investments of $4,003 million, a decrease of $941 million from December 31, 2011. Included in the cash and short-term investments of Prudential Financial is $185 million held in an intercompany liquidity account that is designed to optimize the use of cash by facilitating the lending and borrowing of funds between Prudential Financial and its subsidiaries on a daily basis. Short-term investments of $1,233 million primarily consist of government agency securities and money market funds.

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The following table sets forth Prudential Financial’s principal sources and uses of cash and short-term investments for the period indicated.

	Nine Months Ended September 30, 2012 (in millions)
Sources:	
Dividends and/or returns of capital from subsidiaries(1)	$ 1,677
Proceeds from the issuance of junior subordinated debt (hybrid securities)	989
Proceeds from stock-based compensation and exercise of stock options	239
Net proceeds under external financing agreements(2)	182
Repayment of funding agreements from Prudential Insurance	77
Total sources	3,164
Uses:	
Repayment of retail medium-term notes	1,066
Capital contributions to subsidiaries(3)	1,015
Repayments of long term senior debt	850
Share repurchases	650
Net payments under intercompany loan agreements(4)	315
Shareholder dividends	53
Repayment of short-term debt, net of issuances	32
Other, net	124
Total uses	4,105
Net decrease in cash and short-term investments	$ 941

(1) Includes dividends and/or returns of capital of $600 million from Prudential Insurance, $415 million from international subsidiaries, $349 million from asset management subsidiaries, $248 million from Prudential Annuities Life Assurance Corporation and $65 million from other subsidiaries.
(2) Represents net repayments under the transitional financing agreements provided in connection with the sale of the real estate brokerage franchise and relocation business in 2011. The financing agreements consisted of three credit facilities: two six-month facilities that were repaid and expired on June 6, 2012 and a three-year facility that was repaid and terminated on October 26, 2012.
(3) Includes capital contributions of $713 million to Pruco Reinsurance, Ltd., $294 million to international insurance and investment subsidiaries, $7 million to asset management subsidiaries and $1 million to other subsidiaries.
(4) Includes a decrease of $1,225 million in net borrowings in our intercompany liquidity account and a repayment of $20 million to Prudential Holdings, LLC, partially offset by net borrowings of $569 million by Pruco Reinsurance, Ltd., $290 million by asset management subsidiaries, $50 million by Pruco Life Insurance Company and $21 million by other subsidiaries.

In June 2012, our Board of Directors authorized the Company to repurchase at management’s discretion up to $1.0 billion of its outstanding Common Stock during the period from July 1, 2012 through June 30, 2013. As of September 30, 2012, 2.7 million shares of our Common Stock were repurchased under this authorization for a total cost of $150 million. The Company exhausted the Board’s previous $1.5 billion repurchase authority which covered the prior twelve-month period. During the first nine months of 2012, 11.5 million shares of our Common Stock were repurchased, for a total cost of $650 million. The timing and amount of any future share repurchases will be determined by management based on market conditions and other considerations. Repurchases may be effected in the open market, through derivative, accelerated repurchase and other negotiated transactions and through plans designed to comply with Rule 10b5-1(c) under the Exchange Act. Numerous factors could affect the timing and amount of any future repurchases under the share repurchase program, including increased capital needs of our businesses due to opportunities for growth and acquisitions, as well as adverse market conditions.

We seek to capitalize all of our subsidiaries and businesses in accordance with their ratings targets, and we believe Prudential Financial’s capitalization and use of financial leverage are consistent with those ratings targets. Our long-term senior debt rating targets for Prudential Financial are “A” for Standard & Poor’s Rating Services, or S&P, Moody’s Investors Service, Inc., or Moody’s, and Fitch Ratings Ltd., or Fitch, and “a” for

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A.M. Best Company, or A.M. Best. Our financial strength rating targets for our domestic life insurance companies are “AA/Aa/AA” for S&P, Moody’s and Fitch, respectively, and “A+” for A.M. Best. Currently, some of our ratings are below these targets. For a description of material rating actions that have occurred from the beginning of 2012 through the date of this filing and a discussion of the potential impacts of ratings downgrades, see “—Ratings.”

Restrictions on Dividends and Returns of Capital from Subsidiaries

Our insurance and various other companies are subject to regulatory limitations on the payment of dividends and other transfers of funds to affiliates. With respect to Prudential Insurance, New Jersey insurance law provides that, except in the case of extraordinary dividends (as described below), all dividends or other distributions paid by Prudential Insurance may be paid only from unassigned surplus, as determined pursuant to statutory accounting principles, less unrealized investment gains and losses and revaluation of assets as of the prior calendar year-end. As of December 31, 2011, Prudential Insurance’s unassigned surplus was $5,070 million, and it recorded applicable adjustments for cumulative unrealized investment gains of $2,184 million. Prudential Insurance must give prior notification to the New Jersey Department of Banking and Insurance, or NJDOBI, or the Department, of its intent to pay any dividend or distribution. Also, if any dividend, together with other dividends or distributions made within the preceding twelve months, exceeds the greater of (i) 10% of the prior calendar year’s statutory surplus or (ii) the prior calendar year’s statutory net gain from operations, which excludes realized investment gains and losses, the dividend is considered to be an “extraordinary dividend” and the prior approval of the Department is required for payment of the dividend. Prudential Insurance’s statutory surplus as of December 31, 2011, was $8,160 million and its statutory net gain from operations, excluding realized investment gains and losses, for the year ended December 31, 2011, was $584 million. The laws regulating dividends of the other states where our other domestic insurance companies are domiciled are similar, but not identical, to New Jersey’s. The ability of our asset management subsidiaries to pay dividends is largely unrestricted from a regulatory standpoint. Nevertheless, the payment of dividends by any of our subsidiaries is subject to declaration by their Board of Directors and can be affected by market conditions and other factors. In addition to the regulatory limitations, the terms of the IHC debt contain restrictions potentially limiting dividends by Prudential Insurance applicable to the Financial Services Businesses in the event the Closed Block Business is in financial distress and under certain other circumstances.

On May 18, 2012, Prudential Insurance paid an ordinary dividend of $316 million and an extraordinary dividend of $284 million to its parent, Prudential Holdings, LLC, all of which was in turn distributed to Prudential Financial. On June 29, 2012, Prudential Annuities Life Assurance Corporation paid an extraordinary dividend of $248 million to Prudential Financial. On September 6, 2012, Prudential Retirement Insurance and Annuity Company paid an ordinary dividend of $200 million to its parent, Prudential Insurance.

With respect to The Prudential Life Insurance Company Ltd., or POJ, and Gibraltar Life, Japan insurance law provides that common stock dividends may be paid in an amount of up to 100% of prior fiscal year statutory earnings, after certain reserving thresholds are met including providing for policyholder dividends. POJ and Gibraltar must give prior notification to the Financial Services Agency, or the FSA, of their intent to pay any dividend or distribution. Also, dividends in excess of prior fiscal year earnings and other forms of capital distribution require the prior approval of the FSA. Although Gibraltar is able to pay common stock dividends to Prudential Financial, subject to these legal and regulatory restrictions, we do not anticipate receiving common stock dividends for several years as Gibraltar may return capital to Prudential Financial through other means, such as the repayment of subordinated debt or preferred stock obligations held by Prudential Financial or other affiliates. Based on fiscal year-end March 31, 2012 results, in the second quarter of 2012, POJ declared a dividend of ¥19 billion, or approximately $237 million, to its parent, Prudential Holdings of Japan. We expect this dividend to be paid in the fourth quarter of 2012. On July 27, 2012, Gibraltar Life repaid ¥31.5 billion, or $401 million, in subordinated debt to its parent, Prudential Holdings of Japan, of which $259 million was ultimately sent to Prudential Financial.

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Alternative Sources of Liquidity

Prudential Financial maintains an intercompany liquidity account that is designed to optimize the use of cash by facilitating the lending and borrowing of funds between Prudential Financial and its affiliates on a daily basis. Depending on the overall availability of cash, Prudential Financial invests excess cash on a short-term basis or borrows funds in the capital markets. Additional longer term liquidity is available through inter-affiliate borrowing arrangements. Prudential Financial and certain of its subsidiaries also have access to the alternative sources of liquidity described below.

Commercial Paper Programs

Prudential Financial and Prudential Funding, LLC, or Prudential Funding, a wholly-owned subsidiary of Prudential Insurance, have commercial paper programs with an authorized issuance capacity of $3.0 billion and $7.0 billion, respectively. Prudential Financial commercial paper borrowings generally have been used to fund the working capital needs of our subsidiaries. Prudential Funding commercial paper borrowings have generally served as an additional source of financing to meet the working capital needs of Prudential Insurance and its subsidiaries. Prudential Funding also lends to other subsidiaries of Prudential Financial up to limits agreed with NJDOBI. Prudential Funding maintains a support agreement with Prudential Insurance whereby Prudential Insurance has agreed to maintain Prudential Funding’s positive tangible net worth at all times. Prudential Financial has also issued a subordinated guarantee covering Prudential Funding’s commercial paper program. As of September 30, 2012, Prudential Financial and Prudential Funding had outstanding borrowings of $264 million and $700 million, respectively, under these commercial paper programs. The daily average commercial paper outstanding during the nine months ended September 30, 2012 for the Prudential Financial and Prudential Funding programs was $268 million and $935 million, respectively. For additional information on our commercial paper programs, see Note 9 to the Unaudited Interim Consolidated Financial Statements.

Asset-based Financing

We conduct asset-based or secured financing within our insurance and other subsidiaries, including transactions such as securities lending, repurchase agreements and mortgage dollar rolls to earn spread income, to borrow funds, or to facilitate trading activity. These programs are primarily driven by portfolio holdings of securities that are lendable based on counterparty demand for these securities in the marketplace. The collateral received in connection with these programs is primarily used to purchase securities in the short-term spread portfolios of our domestic insurance entities. Investments held in the short-term spread portfolios include cash and cash equivalents, short-term investments, mortgage loans and fixed maturities, including mortgage- and asset-backed securities, with a weighted average life at time of purchase by the short-term portfolios of four years or less. A portion of the asset-backed securities held in our short-term spread portfolios, including our enhanced short-term portfolio, are collateralized by sub-prime mortgages. Floating rate assets comprise the majority of our short-term spread portfolio. These short-term portfolios are subject to specific investment policy statements, which among other things, do not allow for significant asset/liability interest rate duration mismatch.

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The following table sets forth our liabilities under asset-based or secured financing programs attributable to the Financial Services Businesses and Closed Block Business as of the dates indicated.

	September 30, 2012			December 31, 2011		
	Financial Services Businesses	Closed Block Business	Consolidated	Financial Services Businesses	Closed Block Business	Consolidated
	(in millions)					
Securities sold under agreements to repurchase	$ 4,662	$ 3,371	$ 8,033	$ 3,118	$ 3,100	$ 6,218
Cash collateral for loaned securities	2,442	934	3,376	2,254	719	2,973
Securities sold but not yet purchased	32	0	32	5	0	5
Total(1)	$ 7,136	$ 4,305	$ 11,441	$ 5,377	$ 3,819	$ 9,196
Portion of above securities that may be returned to the Company overnight requiring immediate return of the cash collateral	$ 5,055	$ 2,161	$ 7,216	$ 3,438	$ 2,012	$ 5,450
Weighted average maturity, in days(2)	32	32		62	72	

(1) The daily weighted average outstanding for the three and nine months ended September 30, 2012 was $7,259 million and $6,623 million, respectively, for the Financial Services Businesses and $4,585 million and $4,398 million, respectively, for the Closed Block Business.
(2) Excludes securities that may be returned to the Company overnight.

The $2.2 billion increase in these programs during the first nine months of 2012 has been driven by attractive financing and investment opportunities.

In addition, as of September 30, 2012, our Closed Block Business had outstanding mortgage dollar rolls, under which we are committed to repurchase $548 million of mortgage-backed securities, or TBA forward contracts. These repurchase agreements do not qualify as secured borrowings and are accounted for as derivatives. These mortgage-backed securities are considered high or highest quality based on NAIC or equivalent rating.

As of September 30, 2012, our domestic insurance entities had assets eligible for the asset-based or secured financing programs of $82.4 billion, of which $11.2 billion were on loan. Taking into account market conditions and outstanding loan balances as of September 30, 2012, we believe approximately $29.2 billion of the remaining eligible assets are readily lendable, of which approximately $20.6 billion relates to the Financial Services Businesses; however, these amounts are subject to potential regulatory constraints and to changes in market conditions.

Membership in the Federal Home Loan Banks

Prudential Insurance is a member of the Federal Home Loan Bank of New York, or FHLBNY. Membership allows Prudential Insurance access to the FHLBNY’s financial services, including the ability to obtain loans and to issue funding agreements as an alternative source of liquidity that are collateralized by qualifying mortgage-related assets or U.S. Treasury securities. Under FHLBNY guidelines, if Prudential Insurance’s financial strength ratings decline below A/A2/A Stable by S&P/Moody’s/Fitch, respectively, and the FHLBNY does not receive written assurances from NJDOBI regarding Prudential Insurance’s solvency, new borrowings from the FHLBNY would be limited to a term of 90 days or less. Currently there are no restrictions on the term of borrowings from the FHLBNY. NJDOBI permits Prudential Insurance to pledge collateral to the FHLBNY in an amount of up to 5% of its statutory net admitted assets, excluding separate account assets. Based on this limitation and after taking into account required collateralization levels and purchases of activity-based stock, as of September 30, 2012, Prudential Insurance had an estimated maximum borrowing capacity of $6.3 billion under the FHLBNY facility, of which $2.4 billion was outstanding. Nevertheless, FHLBNY borrowings are subject to the FHLBNY’s discretion and to the availability of qualifying assets at Prudential Insurance.

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Prudential Retirement Insurance and Annuity Company, or PRIAC, is a member of the Federal Home Loan Bank of Boston, or FHLBB, which provides PRIAC access to collateralized advances. As of September 30, 2012, based on guidance from the Connecticut Department of Insurance, PRIAC had an estimated maximum borrowing capacity of $1.6 billion under the FHLBB facility; however, no advances were outstanding.

For additional information on our participation in the Federal Home Loan Bank programs, see Note 9 to the Unaudited Interim Consolidated Financial Statements.

Credit Facilities

We have access to an aggregate of $3.75 billion of syndicated, committed credit facilities, which includes a $2 billion five-year facility expiring in December 2016 that has Prudential Financial as borrower and a $1.75 billion three-year facility expiring in December 2014 that has both Prudential Financial and Prudential Funding as borrowers. There were no outstanding borrowings under these credit facilities as of September 30, 2012 or as of the date of this filing.

The facilities may be used for general corporate purposes, including as backup liquidity for our commercial paper programs. Prudential Financial expects that it may borrow under the five-year credit facility from time to time to fund its working capital needs and those of its subsidiaries. In addition, up to $300 million of the five-year facility may be drawn in the form of standby letters of credit that can be used to meet the Company’s operating needs. The credit facilities contain representations and warranties, covenants and events of default that are customary for facilities of this type; however, borrowings under the facilities are not contingent on our credit ratings nor subject to material adverse change clauses. Borrowings are conditioned on the continued satisfaction of customary conditions, including the maintenance at all times of consolidated net worth, relating to the Company’s Financial Services Businesses only, of at least $18.985 billion, which for this purpose is calculated as U.S. GAAP equity, excluding “Accumulated other comprehensive income (loss)” and excluding equity of noncontrolling interests. As of September 30, 2012 and December 31, 2011, the consolidated net worth of the Company’s Financial Services Businesses exceeded the minimum amount required to borrow under the credit facilities.

Liquidity and Capital Resources of Our Subsidiaries

Domestic Insurance Subsidiaries

General Liquidity

We manage the liquidity of our domestic insurance operations to ensure stable, reliable and cost-effective sources of cash flows to meet all of our obligations. Liquidity is provided by a variety of sources, as described more fully below, including portfolios of liquid assets. The investment portfolios of our domestic operations are integral to the overall liquidity of those operations. We segment our investment portfolios and employ an asset/liability management approach specific to the requirements of our product lines. This enhances the discipline applied in managing the liquidity, as well as the interest rate and credit risk profiles, of each portfolio in a manner consistent with the unique characteristics of the product liabilities. We use a projection process for cash flows from operations to ensure sufficient liquidity is available to meet projected cash outflows, including claims. The impact of Prudential Funding’s financing capacity on liquidity, as discussed more fully under “—Alternative Sources of Liquidity,” is considered in the internal liquidity measures of the domestic insurance operations.

Liquidity is measured against internally-developed benchmarks that take into account the characteristics of both the asset portfolio and the liabilities that they support. The results are affected substantially by the overall asset type and quality of our investments.

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Cash Flow

The principal sources of liquidity for Prudential Insurance and our other domestic insurance subsidiaries are premiums and certain annuity considerations, investment and fee income, and investment maturities and sales associated with our insurance and annuity operations, as well as internal and external borrowings. The principal uses of that liquidity include benefits, claims, dividends paid to policyholders, and payments to policyholders and contractholders in connection with surrenders, withdrawals and net policy loan activity. Other uses of liquidity include commissions, general and administrative expenses, purchases of investments, hedging activity and payments in connection with financing activities.

We believe that the cash flows from our operations are adequate to satisfy the current liquidity requirements of these operations, including under reasonably foreseeable stress scenarios. The continued adequacy of this liquidity will depend upon factors such as future securities market conditions, changes in interest rate levels, policyholder perceptions of our financial strength, and the relative safety and attractiveness of competing products, each of which could lead to reduced cash inflows or increased cash outflows. In addition, market volatility can impact the level of capital required to support our businesses, particularly in our annuity business. Our domestic insurance operations’ cash flows from investment activities result from repayments of principal, proceeds from maturities and sales of invested assets and investment income, net of amounts reinvested. The primary liquidity risks with respect to these cash flows are the risk of default by debtors or bond insurers, our counterparties’ willingness to extend repurchase and/or securities lending arrangements, commitments to invest and market volatility. We closely manage these risks through our credit risk management process and regular monitoring of our liquidity position.

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

	September 30, 2012		December 31, 2011	
	Amount	% of Total	Amount	% of Total
	($ in millions)			
Not subject to discretionary withdrawal provisions	$ 38,288	46%	$ 38,896	47%
Subject to discretionary withdrawal, with adjustment:				
With market value adjustment	22,795	27	22,211	27
At market value	2,578	3	2,208	3
At contract value, less surrender charge of 5% or more	1,810	2	2,036	2
Subtotal	65,471	78	65,351	79
Subject to discretionary withdrawal at contract value with no surrender charge or surrender charge of less than 5%	17,777	22	17,760	21
Total annuity reserves and deposit liabilities	$ 83,248	100%	$ 83,111	100%

Individual life insurance policies are less susceptible to withdrawal than our annuity reserves and deposit liabilities because policyholders may incur surrender charges and be subject to a new underwriting process in order to obtain a new insurance policy. Our annuity reserves with guarantee features may be less susceptible to withdrawal than historical experience indicates, due to the perceived value of these guarantee features to policyholders as a result of market declines in recent years. Annuity benefits and guaranteed investment withdrawals under group annuity contracts are generally not subject to early withdrawal. Gross account withdrawals for our domestic insurance operations’ products were consistent with our assumptions in asset/liability management, and the associated cash outflows did not have a material adverse impact on our overall liquidity.

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Liquid Assets

Liquid assets include cash and cash equivalents, short-term investments, fixed maturities that are not designated as held-to-maturity and public equity securities. Our domestic insurance companies’ liquidity is managed through access to substantial investment portfolios as well as a variety of instruments available for funding and/or managing cash flow mismatches, including from time to time those arising from claim levels in excess of projections. As part of our management process, we consider attributes of the various categories of liquid assets (for example, type of asset and credit quality) in calculating internal liquidity measures to evaluate the adequacy of our domestic insurance operations’ liquidity under a variety of stress scenarios. We believe that the liquidity profile of our assets is sufficient to satisfy current liquidity requirements, including under reasonably foreseeable stress scenarios.

The following table sets forth the fair value of our domestic insurance operations portfolio of liquid assets, including cash and short-term investments, fixed maturity investments other than those designated as held-to-maturity, by NAIC or equivalent rating, and public equity securities, as of the dates indicated.

	September 30, 2012	December 31, 2011
	(in billions)	
Cash and short-term investments	$ 6.5	$ 6.6
Fixed maturity investments:		
High or highest quality	130.9	124.6
Other than high or highest quality	9.6	10.3
Subtotal fixed maturity investments	140.5	134.9
Public equity securities	3.2	3.3
Total	$ 150.2	$ 144.8

Given the size and liquidity profile of our investment portfolios, we believe that claim experience varying from our projections does not constitute a significant liquidity risk. Our asset/liability management process takes into account the expected maturity of investments and expected claim payments as well as the specific nature and risk profile of the liabilities. To the extent we need to pay claims in excess of projections, we may borrow temporarily or sell investments sooner than anticipated to pay these claims, which may result in increased borrowing costs or realized investment gains or losses affecting results of operations. Additionally, we believe that borrowing temporarily or selling investments earlier than anticipated will not have a material impact on the liquidity of our domestic insurance companies. However, payment of claims and sale of investments earlier than anticipated would have an impact on the reported level of cash flow from operating, investing, and financing activities, respectively, in our financial statements. Instead of selling investments at depressed market prices externally, in order to preserve economic value (including tax attributes), we may also sell investments from one subsidiary to another at fair market value or transfer investments internally between businesses within the same subsidiary, subject to applicable regulatory constraints. Historically, there has been no significant variation between the expected maturities of our investments and the payment of claims.

Capital

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

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491% as of December 31, 2011. The RBC ratio is an annual calculation; however based upon September 30, 2012 amounts, we estimate that the RBC ratios for Prudential Insurance and our other domestic life insurance subsidiaries would exceed the minimum level required by applicable insurance regulations. The reporting of RBC measures is not intended for the purpose of ranking any insurance company or for use in connection with any marketing, advertising or promotional activities.

The level of statutory capital of our domestic life insurance subsidiaries can be materially impacted by interest rate and equity market fluctuations, changes in the values of derivatives, the level of impairments recorded, credit quality migration of the investment portfolio, and business growth, among other items. Further, the recapture of business subject to reinsurance arrangements due to defaults by, or credit quality migration affecting, the reinsurers could result in higher required statutory capital levels. The level of statutory capital of our domestic life insurance subsidiaries is also affected by statutory accounting rules, which are subject to change by insurance regulators.

As part of our Capital Protection Framework, we have developed a broad view of the impact of market distress on the statutory capital of the Company. The program focuses on tail risk to protect our capital in a cost-effective manner under stress scenarios. To support this tail risk, in addition to holding on-balance sheet and other contingent sources of capital, we purchase equity index-linked derivatives that are designed to mitigate the impact of a severe equity market stress event on statutory capital. We assess the composition of our hedging program on an ongoing basis, and we may change it from time to time based on our evaluation of our risk position or other factors. Additionally, we may choose to manage the interest rate risk associated with certain of our products by holding capital against a portion of the interest rate exposure. The capital consequences associated with our decision to utilize this risk management strategy have been factored into the Capital Protection Framework.

Captive Reinsurance Companies

We utilize captive reinsurance companies to more effectively manage our capital on an economic basis. To support the risks they assume, our captives are capitalized to a level consistent with the financial strength rating targets of our domestic insurance entities. All of our captive reinsurance companies are wholly-owned subsidiaries and are typically organized in the state of domicile of the direct writing entity that cedes business to the captive.

Our domestic life insurance subsidiaries are subject to a regulation entitled “Valuation of Life Insurance Policies,” commonly known as “Regulation XXX,” and a supporting guideline entitled “The Application of the Valuation of Life Insurance Policies,” commonly known as “Guideline AXXX.” This regulation and supporting guideline require insurers to establish statutory reserves for term and universal life insurance policies with long-term premium guarantees that are consistent with the statutory reserves required for other individual life insurance policies with similar guarantees. Many market participants believe that this level of reserves is non-economic. We use captive reinsurance companies to implement reinsurance and capital management actions, including financing these non-economic reserves through internal and external solutions, to mitigate the impact of Regulation XXX and Guideline AXXX on our term and universal life insurance business. See “Prudential Financial—Financing Activities—Consolidated Borrowings—Financing of regulatory reserves associated with domestic life insurance products” below for additional information on our financing activities related to Regulation XXX and Guideline AXXX.

We reinsure living benefit guarantees on certain variable annuity and retirement products from our domestic life insurance companies to a captive reinsurance company, Pruco Reinsurance, Ltd., or Pruco Re. This enables us to execute our living benefit hedging program primarily within one legal entity, Pruco Re. In this living benefits hedging program, we enter into a range of exchange-traded and over the counter equity and interest rate derivatives to hedge certain optional living benefit features accounted for as embedded derivatives against changes in certain capital market assumptions such as interest rate and equity market levels. For a full discussion

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our living benefits hedging program, see “—Results of Operations for Financial Services Businesses by Segment—U.S. Retirement Solutions and Investment Management Division—Individual Annuities.” Through our Capital Protection Framework discussed above, we maintain access to on-balance sheet capital and contingent sources of capital that are available to meet capital needs that may arise related to this hedging program. These capital needs can vary due to, among other items, changes in equity markets, interest rates, mortality and policyholder behavior.

Effective as of July 1, 2011, Pruco Re re-domiciled from Bermuda to Arizona. As a result, beginning in the third quarter of 2011, our Arizona domiciled life insurance company, Pruco Life Insurance Company, is able to claim statutory reinsurance reserve credit for business ceded to Pruco Re without any need for Pruco Re to collateralize its obligations under the reinsurance arrangement. However, for business ceded to Pruco Re by Prudential Annuities Life Assurance Corporation, or PALAC, and Pruco Life Insurance Company of New Jersey, or PLNJ, we must continue to collateralize Pruco Re’s obligations under the reinsurance arrangement in order for PALAC and PLNJ to claim reinsurance reserve credit for their business ceded. We satisfy this requirement by depositing assets into statutory reserve credit trusts for Pruco Re. Funding needs for the statutory reserve credit trusts are separate and distinct from the capital needs of Pruco Re. However, assets pledged to the statutory reserve credit trusts may include assets supporting the capital of Pruco Re, provided that they meet eligibility requirements prescribed by the Arizona Department of Insurance. Reinsurance reserves credit requirements can move materially in either direction due to changes in equity markets and interest rates, actuarial assumptions and other factors. Higher reinsurance reserves credit requirements would require us to deposit additional assets in the statutory reserve credit trusts, while lower reinsurance reserves credit requirements would allow assets to be removed from the statutory reserve credit trusts. Lower interest rates offset by the impact of higher equity markets during the first nine months of 2012 led to an increase in our need to fund the captive reinsurance trusts by an amount of $113 million.

We formed a captive reinsurance company domiciled in New Jersey to reinsure 90% of the short-term risks under the policies in Prudential Insurance’s Closed Block. These short-term risks represent the impact of variations in experience of the Closed Block that are expected to be recovered over time as a result of corresponding adjustments to policyholder dividends. The reinsurance arrangement is intended to alleviate the short-term surplus volatility within Prudential Insurance resulting from the Closed Block, including volatility caused by the impact of any unrealized mark-to-market losses or realized credit losses within the investment portfolio of the Closed Block. In connection with the Closed Block reinsurance arrangement, we entered into a $2 billion letter of credit facility with certain financial institutions, pursuant to which the New Jersey captive can obtain a letter of credit during a 3-year availability period to support its funding obligations under the reinsurance arrangement. Prudential Financial guarantees all obligations of the New Jersey captive under the facility, including its obligation to reimburse any draws made under a letter of credit. Because experience of the Closed Block is ultimately passed along to policyholders over time through the annual policyholder dividend, we believe that any draw under a letter of credit is unlikely. Our ability to obtain a letter of credit under the facility is subject to the continued satisfaction of customary conditions, including the satisfaction of the same minimum net worth covenant for the Financial Services Businesses as in our syndicated credit facilities described under “Credit Facilities” above and maintenance of at least $5.5 billion of total adjusted capital by Prudential Insurance based on statutory accounting principles prescribed under New Jersey law.

International Insurance Subsidiaries

In our international insurance operations, liquidity is provided through operating cash flows from ongoing operations as well as portfolios of liquid assets. In managing the liquidity, and the interest rate and credit risk profiles of our international insurance portfolios, we employ a discipline similar to the discipline employed for our domestic insurance subsidiaries. We monitor liquidity through the use of internal liquidity measures, taking into account the liquidity of the asset portfolios. We also consider attributes of the various categories of liquid assets (for example, type of asset and credit quality) in calculating internal liquidity measures to evaluate the adequacy of our international insurance operations’ liquidity under stress scenarios. We believe that ongoing operations and the liquidity profile of our international insurance assets provide sufficient liquidity under reasonably foreseeable stress scenarios.

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The following table sets forth the fair value of our international insurance operations’ portfolio of liquid assets, including cash and short-term investments, fixed maturity investments other than those designated as held-to-maturity, by NAIC or equivalent rating, and public equity securities, as of the dates indicated.

	September 30, 2012				
	Prudential of Japan	Gibraltar Life(1)	All Other(2)	Total	December 31, 2011
			(in billions)		
Cash and short-term investments	$ 1.6	$ 4.7	$ 0.2	$ 6.5	$ 5.4
Fixed maturity investments:					
High or highest quality(3)	31.2	92.2	11.2	134.6	120.6
Other than high or highest quality	0.4	2.0	0.1	2.5	2.0
Subtotal	31.6	94.2	11.3	137.1	122.6
Public equity securities	1.2	2.1	0.4	3.7	3.4
Total	$ 34.4	$ 101.0	$ 11.9	$ 147.3	$ 131.4

(1) Includes Prudential Gibraltar Financial Life Insurance Company, Ltd., or Prudential Gibraltar, a wholly-owned subsidiary of Gibraltar Life.
(2) Represents our international insurance operations, excluding Japan.
(3) Of the $134.6 billion of fixed maturity investments that are not designated as held–to-maturity and considered high or highest quality as of September 30, 2012, $93 billion, or 69%, were invested in government or government agency bonds.

As with our domestic operations, in managing the liquidity of these operations, we consider the risk of policyholder and contractholder withdrawals of funds earlier than our assumptions in selecting assets to support these contractual obligations. The following table sets forth the total general account insurance-related liabilities (other than dividends payable to policyholders) of our international insurance subsidiaries, as of the dates indicated.

	September 30, 2012	December 31, 2011
	(in billions)	
Prudential of Japan(1)	$ 38.9	$ 36.6
Gibraltar Life	102.9	96.6
All other international insurance subsidiaries(2)	9.9	8.6
Total general account insurance-related liabilities (other than dividends payable to policyholders)	$ 151.7	$ 141.8

(1) As of September 30, 2012 and December 31, 2011, $5.4 billion and $4.5 billion, respectively, of the insurance-related liabilities for Prudential of Japan are associated with U.S. dollar-denominated products that are coinsured to our U.S. domiciled insurance operations and supported by U.S. dollar-denominated assets.
(2) Represents our international insurance operations, excluding Japan.

Our Japanese operations did not have a material amount of general account annuity reserves or deposit liabilities subject to discretionary withdrawal without a market value adjustment as of September 30, 2012 and December 31, 2011. Additionally, we believe that the longer term recurring pay individual life insurance policies sold by our Japanese operations do not have significant withdrawal risk because policyholders may incur surrender charges and must undergo a new underwriting process in order to obtain a new insurance policy. Individual life insurance policies sold by our Japanese operations with a higher savings component may be subject to increased levels of surrenders if interest rates increase.

Similar to the RBC ratios that are employed by U.S. insurance regulators, regulatory authorities in the international jurisdictions in which we operate generally establish some form of minimum solvency margin requirements for insurance companies. All of our international insurance subsidiaries have solvency margins in excess of the minimum levels required by the applicable regulatory authorities. These solvency margins are also

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a primary measure by which we evaluate the capital adequacy of our international insurance operations. We manage these solvency margins to a capitalization level consistent with our “AA” ratings target. Maintenance of our solvency ratios at certain levels is also important to our competitive positioning, as in certain jurisdictions, such as Japan, these solvency margins are required to be disclosed to the public and therefore impact the public perception of an insurer’s financial strength.

Solvency margin levels in our international insurance subsidiaries can be materially impacted by interest rate, equity market and real estate market fluctuations, the level of impairments recorded, credit quality migration of the investment portfolio, changes in regulation, and foreign exchange rate movements, among other items. We evaluate the solvency margin capital levels of our Japanese insurance operations under reasonably foreseeable stress scenarios and believe our solvency margin levels would be comfortably above regulatory requirements under these scenarios.

The Financial Services Agency, the insurance regulator in Japan, has implemented revisions to the solvency margin requirements to alter risk charges for certain assets and change the manner in which an insurance company’s core capital is calculated. These changes became effective for the fiscal year ended March 31, 2012. Under this new method, the fiscal year-end solvency margin ratios for our Japanese insurance subsidiaries continue to exceed our targets. The March 31, 2012 solvency margin ratio for Gibraltar also reflects the merger of Star, Edison, and Gibraltar Life, which was effective January 1, 2012. The table below presents the solvency margins of our Japanese insurance subsidiaries under the new method as of March 31, 2012.

	March 31, 2012
Prudential of Japan	721%
Gibraltar Life Consolidated	810%
Gibraltar Life	862%
Prudential Gibraltar(1)	756%

(1) Represents Prudential Gibraltar Financial Life Insurance Company, Ltd., a wholly-owned subsidiary of Gibraltar Life.

We employ various hedging strategies to manage potential exposure to foreign currency exchange rate movements, including the strategies discussed in “—Results of Operations for Financial Services Businesses by Segment—International Insurance Division.” These hedging strategies include both internal and external hedging programs.

The internal hedges are between a subsidiary of Prudential Financial and certain of our yen-based entities and serve to hedge a portion of the value of U.S. dollar-denominated investments held on the books of these yen-based entities. These U.S. dollar-denominated investments are part of our hedging strategy to mitigate the impact of foreign currency exchange rate movements on our U.S. dollar-equivalent investment in our Japanese subsidiaries. Absent an internal hedge, the changes in market value of these U.S. dollar-denominated investments attributable to changes in the yen-dollar exchange rate would create volatility in the solvency margins of these subsidiaries. In order to minimize this volatility, we enter into inter-company hedges. Cash settlements from these hedging activities result in cash flows between Prudential Financial and these yen-based subsidiaries. The cash flows are dependent on changes in foreign currency exchange rates and the notional amount of the exposures hedged. During the first nine months of 2012, Prudential Financial funded $85 million of cash settlements related to the internal hedge program, which were paid to the yen-based subsidiaries. As of September 30, 2012, the market value of the internal hedges was a liability of $837 million owed to the yen-based subsidiaries of Prudential Financial. Absent any changes in forward exchange rates from those expected as of September 30, 2012, the $837 million internal hedge liability represents the present value of the net cash flows from Prudential Financial to these entities over the life of the hedging instruments, up to 30 years, and would require additional liquidity and capital to fund contributions from Prudential Financial to our subsidiaries. A significant yen appreciation over an extended period of time, and in excess of the forward exchange rates, would result in higher capital and liquidity needs to fund the net cash outflows from Prudential Financial.

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Our external hedges primarily serve to hedge foreign-denominated future income of our foreign subsidiaries and equity investments in certain of these subsidiaries. The external hedges are between a subsidiary of Prudential Financial and external parties. Cash settlements on these activities result in cash flows between Prudential Financial and the external parties and are dependent on changes in foreign currency exchange rates and the notional amount of the exposures hedged. During the first nine months of 2012, Prudential Financial paid $89 million of net cash flows for international insurance-related external hedge settlements. As of September 30, 2012, the net liability related to external foreign currency hedges was $415 million. A significant appreciation in the yen and other foreign currencies could result in net cash outflows in excess of our liability.

Asset Management Subsidiaries

Our asset management businesses, which include real estate, public and private fixed income and public equity asset management, as well as commercial mortgage origination and servicing, and retail investment products, such as mutual funds and other retail services, are largely unregulated from the standpoint of dividends and distributions. Our asset management subsidiaries through which we conduct these businesses generally do not have restrictions on the amount of distributions they can make, and the fee-based asset management business can provide a relatively stable source of cash flow to Prudential Financial.

The principal sources of liquidity for our fee-based asset management businesses include asset management fees and commercial mortgage servicing fees. The principal uses of liquidity include general and administrative expenses and distribution of dividends and returns of capital to Prudential Financial. The primary liquidity risks for our fee-based asset management businesses relate to their profitability, which is impacted by market conditions and our investment management performance. We believe the cash flows from our fee-based asset management businesses are adequate to satisfy the current liquidity requirements of these operations, as well as requirements that could arise under reasonably foreseeable stress scenarios, which are monitored through the use of internal measures.

The principal sources of liquidity for our strategic investments and interim loans held in our asset management businesses are cash flows from investments, the ability to liquidate investments, and available borrowing lines from internal sources, including Prudential Funding and Prudential Financial. The primary liquidity risks include the inability to sell assets in a timely manner, declines in the value of assets and credit defaults.

Our commercial mortgage origination and servicing business participates in a Fannie Mae alternative delivery program known as ASAP Plus (“As Soon as Pooled” delivery). Our approval limit for outstanding balances on ASAP Plus is $150 million. This program allows us to assign a qualified Fannie Mae loan trade commitment to Fannie Mae as early as the next business day after a loan closes, and receive 99% of the loan purchase price from Fannie Mae. The program does not eliminate the need to provide temporary warehouse financing, but does significantly reduce the duration of funding requirements for eligible Fannie Mae originated loans from the normal delivery cycle of two to four weeks down to as little as one to two days. There was no balance outstanding on this program as of September 30, 2012.

Certain real estate funds under management are held for the benefit of clients in insurance company separate accounts sponsored by Prudential Insurance. In the normal course of business, Prudential Insurance, on behalf of these separate accounts, may contractually agree to various funding commitments which may include, among other things, commitments to purchase real estate, to invest in real estate partnerships (both existing and to-be-formed) to acquire or develop real estate, and/or to fund additional construction or other expenditures on previously-acquired real estate investments. Certain commitments to purchase real estate are contingent on the developer’s development of the property according to plans and specifications outlined in a pre-sale agreement or the completed property achieving a certain level of leasing. These contractual commitments are typically entered into by Prudential Insurance on behalf of the particular separate account. Real estate investments that are

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acquired for a separate account are titled either in the name of Prudential Insurance or an LLC subsidiary specifically formed to hold title. In the majority of cases, the commitments specify that Prudential Insurance’s recourse liability for the obligation is limited to the assets of the separate account.

At September 30, 2012 and December 31, 2011, total outstanding purchase commitments related to such separate account activity were $2.8 billion and $3.4 billion, respectively, which amounts include both off- and on-balance sheet commitments. The decrease in total outstanding purchase commitments during the last nine months was primarily driven by the satisfaction of outstanding debt commitments, which were funded from investor capital contributions and property sales. The following is a summary of the outstanding purchase commitments for these separate account portfolios as of September 30, 2012. Off-balance sheet commitments include capital commitments and commitments with respect to properties that have not yet substantially satisfied pre-conditions and are considered contingent liabilities. On-balance sheet commitments represent obligations which have substantially satisfied conditions to funding of the commitments.

	Contractual Maturity Date			
	Remaining 2012	2013	After 2013	Total
	(in millions)			
Off-Balance Sheet Commitments:				
Recourse to Prudential Insurance	$ 15	$ 110	$ 0	$ 125
Recourse limited to assets of separate accounts	109	318	371	798
Total Off-Balance Sheet Commitments	124	428	371	923
On-Balance Sheet Commitments:				
Recourse to Prudential Insurance	341	64	17	422
Recourse limited to assets of separate accounts	203	905	318	1,426
Total On-Balance Sheet Commitments	544	969	335	1,848
Total Commitments	$ 668	$ 1,397	$ 706	$ 2,771

The contractual maturity dates of some of the outstanding purchase commitments may accelerate upon a failure to maintain required loan-to-value ratios, failure of Prudential Insurance to maintain required ratings or failure to satisfy other financial covenants.

Some separate accounts have also entered into syndicated credit facilities providing for borrowings in the aggregate amount of up to $0.8 billion. As of September 30, 2012, there were no outstanding borrowings under these credit facilities. These facilities also include loan-to-value ratio requirements and other financial covenants. Recourse on obligations under these facilities is limited to the assets of the applicable separate account. As of September 30, 2012, these separate account portfolios had combined gross and net asset values of $28.4 billion and $19.2 billion, respectively.

At the time of maturity of a funding commitment, Prudential Insurance often endeavors to negotiate extensions, refinancings, or other solutions with counterparties. Management believes that the separate accounts have sufficient resources to ultimately meet their obligations. However, there is a risk that the separate accounts may not be able to timely fund all maturing obligations from regular sources such as asset sales, operating cash flow, deposits from clients, debt refinancings or from the above-mentioned portfolio level credit facilities. In cases where the separate account is not able to fund maturing obligations, Prudential Insurance may be called upon or required to provide interim funding solutions. To date, Prudential Insurance has not been required to provide any such funding.

As of September 30, 2012 and December 31, 2011, our asset management subsidiaries had cash and cash equivalents and short-term investments of $1.2 billion and $1.3 billion, respectively.

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Financing Activities

Prudential Financial maintains a shelf registration statement with the SEC that permits the issuance of public debt, equity and hybrid securities. As a “Well-Known Seasoned Issuer” under SEC rules, Prudential Financial’s shelf registration statement provides for automatic effectiveness upon filing, pay-as-you-go fees and the ability to add securities by filing automatically effective amendments. Also, in accordance with these rules, the shelf registration statement has no stated issuance capacity.

As of September 30, 2012 and December 31, 2011, total short- and long-term debt of the Company on a consolidated basis was $26.9 billion and $27.0 billion, respectively, which includes $17.6 billion and $18.6 billion, respectively, related to the parent company, Prudential Financial.

Issuance of Hybrid Securities

In August 2012, Prudential Financial sold $1 billion aggregate principal amount of 5.875% fixed-to-floating rate junior subordinated notes in a public offering. The notes are considered hybrid securities that receive enhanced equity treatment from the rating agencies. The notes mature on September 15, 2042, and interest is payable semi-annually at a fixed rate of 5.875% until September 15, 2022, after which interest is payable quarterly at a floating rate of 3-month LIBOR plus 4.175%. We have the right to defer interest payments on the notes for a period of up to five years, during which time interest will be compounded. We may redeem notes at par on or after September 15, 2022. We may also redeem the notes, in whole but not in part, prior to September 15, 2022 (i) at par in the event of a future change in the regulatory capital treatment of the notes with respect to the Company or (ii) at the greater of par or a make-whole price in the event of a future change in the tax treatment of the notes or a change relating to the equity credit assigned to the notes by a rating agency. The net proceeds received from the sale of the notes were used for general corporate purposes and to redeem some of our outstanding retail medium-term notes.

Sale of Asset-Backed Notes

On March 30, 2012, Prudential Insurance sold, in a Rule 144A private placement, $1 billion aggregate principal amount of 2.997% notes with a final maturity of September 30, 2015. The notes are secured by the assets of a trust, consisting of approximately $2.8 billion aggregate principal balance of residential mortgage-backed securities deposited into the trust by Prudential Insurance. Payments of interest and principal on the notes will be made only to the extent of funds available to the trust in accordance with a priority of payments set forth in the indenture governing the notes. Prudential Financial guaranteed to the holders of the notes the timely payment of all principal and interest due on the notes and any “make-whole payments” that may become due as a result of the payment of principal on the notes prior to its scheduled payment date. The deposit of the residential mortgage-backed securities into the trust by Prudential Insurance did not result in recognition of a gain or loss on the securities, or de-recognition of the securities from the balance sheet, under statutory accounting principles or U.S. GAAP but is consistent with Prudential Insurance’s overall tax planning strategies to monetize statutory deferred tax assets.

Existing Hybrid Securities and the Related Replacement Capital Covenants

Prudential Financial has outstanding $600 million of 8.875% fixed-to-floating rate junior subordinated notes issued to institutional investors and $920 million of 9.0% fixed-rate junior subordinated notes issued to retail investors. Both issuances are considered hybrid securities that receive enhanced equity treatment from the rating agencies. The 9.0% fixed-rate junior subordinated notes are redeemable by the Company at par on or after June 15, 2013. See Note 14 to our Consolidated Financial Statements included in our 2011 Annual Report on Form 10-K for more information on the junior subordinated notes.

In April 2012, we terminated the replacement capital covenants that were entered into in 2008 in connection with our issuance of these junior subordinated notes. We received the consent of holders of a majority in principal amount of our 6.625% medium-term notes due 2037, as was required for the termination of the

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replacement capital covenants. We also entered into a new replacement capital covenant with respect to the 8.875% junior subordinated notes only. The new replacement capital covenant was entered into for the benefit of the holders of our 5.90% medium-term notes due March 2036 and requires that the Company not repay, redeem or purchase the 8.875% junior subordinated notes prior to June 15, 2038 unless we have received proceeds from the sale or issuance of common stock or other qualifying securities that have certain characteristics that are at least as equity-like as the 8.875% junior subordinated notes. However, the terms of the new replacement capital covenant will not apply in certain instances, including (i) if Standard & Poor’s upgrades our corporate credit rating by at least one notch above “A+” or (ii) if we repurchase or redeem up to 10% of the outstanding principal amount of the 8.875% junior subordinated notes in any one-year period, provided that no more than 25% of the outstanding principal amount of the 8.875% junior subordinated notes are repurchased or redeemed in any ten-year period.

Prudential Financial Borrowings

Prudential Financial is authorized to borrow funds from various sources to meet its capital and other funding needs, as well as the capital and other funding needs of its subsidiaries. The following table sets forth the outstanding short- and long-term debt of Prudential Financial, other than debt issued to consolidated subsidiaries, by contractual maturity, as of the dates indicated.

	Contractual maturities by Calendar Year, as of September, 30, 2012							Total December 31, 2011
	Remaining 2012	**2013**	**2014**	**2015**	**2016**	**2017 and thereafter**	**Total**	
				(in millions)				
General obligation short-term debt:								
Commercial paper	$ 249	$ 15	$ 0	$ 0	$ 0	$ 0	$ 264	$ 296
Current portion of long-term debt	3	1,742	0	0	0	0	1,745	956
Subtotal	252	1,757	0	0	0	0	2,009	1,252
General obligation long-term debt:								
Senior debt	0	0	1,473	2,148	750	7,278	11,649	13,236
Junior subordinated debt	0	0	0	0	0	2,519	2,519	1,519
Retail medium-term notes	0	5	58	74	4	1,278	1,419	2,545
Subtotal	0	5	1,531	2,222	754	11,075	15,587	17,300
Total borrowings	$ 252	$ 1,762	1,531	$ 2,222	$ 754	$ 11,075	$ 17,596	$ 18,552

Prudential Financial maintains a Medium-Term Notes, Series D program under its shelf registration statement with an authorized issuance capacity of $20 billion, of which as of September 30, 2012 approximately $9.1 billion remained available. The weighted average interest rates on Prudential Financial’s medium-term and senior notes, including the effect of interest rate hedging activity, were 5.26% for both the nine months ended September 30, 2012 and 2011, excluding the effect of debt issued to consolidated subsidiaries. During the first nine months of 2012, $850 million of these notes matured.

Prudential Financial also maintains a retail medium-term notes program, including the InterNotes® program, under its shelf registration statement with an authorized issuance capacity of $5.0 billion, of which as of September 30, 2012 approximately $3.8 billion remained available. The retail medium-term notes program traditionally has served as a funding source for a product of our Retirement segment for which we earn investment spread; however, proceeds from the program are also used for general corporate purposes. The weighted average interest rates on Prudential Financial’s retail medium-term notes were 5.94% and 5.85% for the nine months ended September 30, 2012 and 2011, respectively, excluding the effect of debt issued to

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consolidated subsidiaries. As of September 30, 2012, $1.1 billion of the outstanding retail notes were redeemable by the Company at par. During the first nine months of 2012, the Company redeemed $959 million of its outstanding retail notes. We may continue to redeem some or all of the remaining retail notes as part of our overall liquidity and capital management.

Consolidated Borrowings

Current capital markets activities for the Company on a consolidated basis principally consist of unsecured short-term and long-term borrowings by Prudential Funding and Prudential Financial, unsecured third party bank borrowings, and asset-based or secured financing. As of September 30, 2012, we were in compliance with all debt covenants related to the borrowings in the table below.

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

	September 30, 2012	December 31, 2011
	(in millions)	
Borrowings:		
General obligation short-term debt(1)	$ 3,013	$ 2,336
General obligation long-term debt:		
Senior debt	14,711	16,488
Junior subordinated debt (hybrid securities)	2,519	1,519
Surplus notes(2)(3)	4,140	4,140
Other(4)	725	725
Total general obligation long-term debt	22,095	22,872
Total general obligations	25,108	25,208
Limited and non-recourse borrowing:		
Limited and non-recourse long-term debt(5)	1,750	1,750
Total limited and non-recourse borrowing	1,750	1,750
Total borrowings(6)	26,858	26,958
Total asset-based financing	11,441	9,196
Total borrowings and asset-based financings	$ 38,299	$ 36,154

(1) As of both September 30, 2012 and December 31, 2011, includes $199 million of short-term debt representing collateralized advances with the Federal Home Loan Bank of New York.
(2) As of both September 30, 2012 and December 31, 2011, includes $3.2 billion of floating rate surplus notes issued by subsidiaries of Prudential Insurance to fund regulatory reserves, as well as $940 million of fixed rate surplus notes issued by Prudential Insurance.
(3) As of September 30, 2012 and December 31, 2011, the $4.1 billion of surplus notes outstanding is net of $750 million and $500 million, respectively, of assets under set-off arrangements, respectively, representing a reduction in the amount of surplus notes included in long-term debt, relating to an arrangement where valid rights of offset exist and it is the intent of both parties to settle on a net basis under legally enforceable arrangements.
(4) Reflects collateralized advances with Federal Home Loan Bank of New York.

(5) As of both September 30, 2012 and December 31, 2011, the limited and non-recourse long-term debt outstanding was attributable to the Closed Block Business.

(6) Does not include $2.3 billion and $3.2 billion of medium-term notes of consolidated trust entities secured by funding agreements purchased with the proceeds of such notes as of September 30, 2012 and December 31, 2011, respectively, or $1.5 billion of collateralized funding agreements issued to the Federal Home Loan Bank of New York as of both September 30, 2012 and December 31, 2011. These notes and funding agreements are included in “Policyholders’ account balances.” For additional information on the trust notes, see “—Funding Agreement Notes Issuance Program.”

Total general debt obligations decreased by $100 million from December 31, 2011 to September 30, 2012, primarily reflecting the redemption of retail notes, the maturity of medium-term notes, and a reduction in commercial paper outstanding offset by the issuance of junior subordinated debt and the sale of asset-backed notes as described above.

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Our total borrowings consist of capital debt, investment-related debt, securities business-related debt and debt related to specified other businesses. Capital debt consists of borrowings that are used or will be used to meet the capital requirements of Prudential Financial, as well as borrowings invested in equity or debt securities of direct or indirect subsidiaries of Prudential Financial and subsidiary borrowings utilized for capital requirements. Investment-related borrowings consist of debt issued to finance specific investment assets or portfolios of investment assets, including institutional spread lending investment portfolios, real estate and real estate-related investments held in consolidated joint ventures, assets supporting reserve requirements under Regulation XXX and Guideline AXXX as described below, as well as institutional and insurance company portfolio cash flow timing differences. Securities business-related debt consists of debt issued to finance the liquidity of our capital markets and other securities business-related operations. Debt related to specified other businesses primarily consists of borrowings associated with our individual annuities business. Those borrowings where the holder is entitled to collect only against the assets pledged to the debt as collateral, or where the borrower has only very limited rights to collect against other assets, have been classified as limited and non-recourse debt.

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

	September 30, 2012	December 31, 2011
	(in millions)	
General obligations:		
Capital debt(1)	$ 11,886	$ 11,224
Investment-related	8,535	8,897
Securities business-related	1,071	1,518
Specified other businesses(2)	3,616	3,569
Total general obligations	25,108	25,208
Limited and non-recourse debt(3)	1,750	1,750
Total borrowings	$ 26,858	$ 26,958

(1) Includes $2,519 and $1,519 million of total outstanding junior subordinated debt at September 30, 2012 and December 31, 2011, respectively.
(2) Primarily consists of borrowings associated with our individual annuities business supporting new business acquisition costs in certain life insurance companies, as well as hedging costs, reinsurance reserves credit requirements and other operating needs within Pruco Re.
(3) As of both September 30, 2012 and December 31, 2011, the limited and non-recourse debt outstanding was attributable to the Closed Block Business.

The following table presents, as of September 30, 2012, the contractual maturities of the Company’s total borrowings.

	Financial Services Businesses	Closed Block Business	Consolidated
		(in millions)	
Calendar Year:			
2013 and prior	$ 3,019	$ 75	$ 3,094
2014	2,053	75	2,128
2015	3,801	100	3,901
2016	1,355	125	1,480
2017 and thereafter	14,880	1,375	16,255
Total	$ 25,108	$ 1,750	$ 26,858

We may, from time to time, seek to redeem or repurchase our outstanding debt securities through open market purchases, individually negotiated transactions or otherwise. Any such repurchases will depend on prevailing market conditions, our liquidity position, contractual restrictions and other factors. The amounts involved may be material.

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Financing of regulatory reserves associated with domestic life insurance products

As discussed above under “Liquidity and Capital Resources of our Subsidiaries—Domestic Insurance Subsidiaries—Captive Reinsurance Companies,” we use reinsurance arrangements and financing transactions involving captive reinsurance companies in order to mitigate the impact of Regulation XXX and Guideline AXXX on our term and universal life insurance products. These activities are described below.

During 2011, a captive reinsurance subsidiary entered into agreements providing for the issuance and sale of up to $1 billion of ten-year fixed-rate surplus notes in order to finance reserves required under Regulation XXX. In June 2012, this subsidiary entered into another agreement for the issuance of up to an additional $500 million of ten-year fixed rate surplus notes for the same purpose. At September 30, 2012, an aggregate of $750 million of surplus notes were outstanding under this facility. Under the agreements, the subsidiary received debt securities, with a principal amount equal to the surplus notes issued, which are redeemable under certain circumstances, including upon the occurrence of specified stress events affecting the subsidiary. Because valid rights of set-off exist, interest and principal payments on the surplus notes and on the debt securities are settled on a net basis, and the surplus notes are reflected in the Company’s total consolidated borrowings on a net basis. Prudential Financial has agreed to make capital contributions to the subsidiary in order to reimburse it for investment losses in excess of specified amounts. In addition, during 2011, another captive reinsurance subsidiary issued a $1.5 billion surplus note to an affiliate to finance reserves required under Guideline AXXX.

Other captive reinsurance subsidiaries have outstanding an additional $3.2 billion of surplus notes that were issued in 2006 through 2008 with unaffiliated institutions to finance reserves required under Regulation XXX and Guideline AXXX. Prudential Financial has agreed to maintain the capital of these subsidiaries at or above a prescribed minimum level and has entered into arrangements (which are accounted for as derivative instruments) that require it to make certain payments in the event of deterioration in the value of these surplus notes. As of September 30, 2012 and December 31, 2011, there were no collateral postings made under these derivative instruments.

The surplus notes described above are subordinated to policyholder obligations, and the payment of principal on the surplus notes may only be made with prior insurance regulatory approval. The payment of interest on the surplus notes has been approved by the regulator, subject to the ability of the regulator to withdraw that approval.

As we continue to underwrite term and universal life business, and as we assume the business being ceded to us in the acquisition of The Hartford’s individual life business, we expect to have additional borrowing needs to finance statutory reserves required under Regulation XXX and Guideline AXXX. However, we believe we have sufficient financing resources available, including those internal and external resources described above, to meet our financing needs under Regulation XXX into 2014 and under Guideline AXXX beyond 2014, assuming that the volume of new business remains consistent with current sales projections.

Funding Agreement Notes Issuance Program

Prudential Insurance maintains a Funding Agreement Notes Issuance Program pursuant to which a Delaware statutory trust issues medium-term notes (which are included in our statements of financial position in “Policyholders’ account balances” and not included in the foregoing table) secured by funding agreements issued to the trust by Prudential Insurance and included in our Retirement segment. The funding agreements provide cash flow sufficient for the debt service on the related medium-term notes. The medium-term notes are sold in transactions not requiring registration under the Securities Act of 1933. The notes have fixed or floating interest rates and original maturities ranging from five to ten years. As of September 30, 2012 and December 31, 2011, the outstanding aggregate principal amount of such notes totaled $2.3

billion and $3.2 billion respectively, out of a total authorized amount of up to $15 billion. Our ability to issue under this program depends on market conditions. The aggregate maturities of these notes over the next 12 months are approximately $1.2 billion. We intend to repay the maturing notes through a combination of cash flows from asset maturities and available cash.

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Ratings

Financial strength ratings (which are sometimes referred to as “claims-paying” ratings) and credit ratings are important factors affecting public confidence in an insurer and its competitive position in marketing products. Nationally Recognized Statistical Ratings Organizations continually review the financial performance and financial condition of the entities they rate, including Prudential Financial and its rated subsidiaries. Our credit ratings are also important for our ability to raise capital through the issuance of debt and for the cost of such financing.

A downgrade in the credit or financial strength ratings of Prudential Financial or its rated subsidiaries could potentially, among other things, limit our ability to market products, reduce our competitiveness, increase the number or value of policy surrenders and withdrawals, increase our borrowing costs and potentially make it more difficult to borrow funds, adversely affect the availability of financial guarantees, such as letters of credit, cause additional collateral requirements or other required payments under certain agreements, allow counterparties to terminate derivative agreements and/or hurt our relationships with creditors, distributors or trading counterparties, thereby potentially negatively affecting our profitability, liquidity and/or capital. In addition, we consider our own risk of non-performance in determining the fair value of our liabilities. Therefore, changes in our credit or financial strength ratings may affect the fair value of our liabilities.

Financial strength ratings represent the opinions of rating agencies regarding the financial ability of an insurance company to meet its obligations under an insurance policy. Credit ratings represent the opinions of rating agencies regarding an entity’s ability to repay its indebtedness. The following table summarizes the ratings for Prudential Financial and certain of its subsidiaries as of the date of this filing.

	A.M. Best(1)	S&P(2)	Moody’s(3)	Fitch(4)
Financial Strength Ratings:				
The Prudential Insurance Company of America	A+	AA-	A2	A+
Pruco Life Insurance Company	A+	AA-	A2	A+
Pruco Life Insurance Company of New Jersey	A+	AA-	NR*	A+
Prudential Annuities Life Assurance Corporation	A+	AA-	NR	A+
Prudential Retirement Insurance and Annuity Company	A+	AA-	A2	A+
The Prudential Life Insurance Company Ltd. (Prudential of Japan)	NR	AA-	NR	NR
Gibraltar Life Insurance Company, Ltd.	NR	AA-	NR	NR
Credit Ratings:				
Prudential Financial, Inc.:				
Short-term borrowings	AMB-1	A-1	P-2	F2
Long-term senior debt(5)	a-	A	Baa2	BBB+
Junior subordinated long-term debt	bbb	BBB+	Baa3	BBB-
The Prudential Insurance Company of America:				
Capital and surplus notes	a	A	Baa1	A-
Prudential Funding, LLC:				
Short-term debt	AMB-1	A-1+	P-2	F1
Long-term senior debt	a+	AA-	A3	A
PRICOA Global Funding I:				
Long-term senior debt	aa-	AA-	A2	A+

* “NR” indicates not rated.

(1) A.M. Best Company , which we refer to as A.M. Best, financial strength ratings for insurance companies currently range from “A++ (superior)” to “F (in liquidation).” A.M. Best’s ratings reflect its opinion of an insurance company’s financial strength, operating performance and ability to meet its obligations to policyholders. An A.M. Best long-term credit rating is an opinion of the ability of an obligor to pay interest and principal in accordance with the terms of the obligation. A.M. Best long-term credit ratings range from “aaa (exceptional)” to “d (in

default),” with ratings from “aaa” to “bbb” considered as investment grade. An A.M. Best short-term credit rating reflects an opinion of the issuer’s fundamental credit quality. Ratings range from “AMB-1+,” which represents an exceptional ability to repay short-term debt obligations, to “AMB-4,” which correlates with a speculative (“bb”) long-term rating.

(2) Standard & Poor’s Rating Services, which we refer to as S&P, financial strength ratings currently range from “AAA (extremely strong)” to “R (regulatory supervision).” These ratings reflect S&P’s opinion of an operating insurance company’s financial capacity to meet the obligations of its insurance policies in accordance with their terms. A “+” or “-” indicates relative strength within a category. An S&P credit rating is a current opinion of the creditworthiness of an obligor with respect to a specific financial obligation, a specific class of financial obligations or a specific financial program. S&P’s long-term issue credit ratings range from “AAA (extremely strong)” to “D (default).” S&P short-term ratings range from “A-1 (highest category)” to “D (default).”

(3) Moody’s Investors Service, Inc., which we refer to as Moody’s, insurance financial strength ratings currently range from “Aaa (exceptional)” to “C (lowest).” Moody’s insurance ratings reflect the ability of insurance companies to repay punctually senior policyholder claims and obligations. Numeric modifiers are used to refer to the ranking within the group—with 1 being the highest and 3 being the lowest. These modifiers are used to indicate relative strength within a category. Moody’s credit ratings currently range from “Aaa (highest)” to “C (default).” Moody’s credit ratings grade debt according to its investment quality. Moody’s considers “A1,” “A2” and “A3” rated debt to be upper medium grade obligations, subject to low credit risk. Moody’s short-term ratings are opinions of the ability of issuers to honor senior financial obligations and contracts. Prime ratings range from “Prime-1 (P-1),” which represents a superior ability for repayment of senior short-term debt obligations, to “Prime-3 (P-3),” which represents an acceptable ability for repayment of such obligations. Issuers rated “Not Prime” do not fall within any of the Prime rating categories.

(4) Fitch Ratings Ltd., which we refer to as Fitch, financial strength ratings currently range from “AAA (exceptionally strong)” to “D (distressed).” Fitch’s ratings reflect its assessment of the likelihood of timely payment of policyholder and contractholder obligations. Fitch long-term credit ratings currently range from “AAA (highest credit quality),” which denotes exceptionally strong capacity for timely payment of financial commitments, to “D (default).” Investment grade ratings range between “AAA” and “BBB.” Short-term ratings range from “F1 (highest credit quality)” to “C (high default risk).” Within long-term and short-term ratings, a “+” or a “–” may be appended to a rating to denote relative status within major rating categories.

(5) Includes the retail medium-term notes program.

The ratings set forth above reflect current opinions of each rating agency. Each rating should be evaluated independently of any other rating. These ratings are not directed toward shareholders and do not in any way reflect evaluations of the safety and security of the Common Stock. These ratings are reviewed periodically and may be changed at any time by the rating agencies. As a result, we cannot assure you that we will maintain our current ratings in the future.

Requirements to post collateral or make other payments as a result of ratings downgrades under certain agreements, including derivative agreements, can be satisfied in cash or by posting permissible securities held by the subsidiaries subject to the agreements. A ratings downgrade of three ratings levels from the ratings levels as of September 30, 2012 (relating to financial strength ratings in certain cases and credit ratings in other cases) would result in estimated additional collateral posting requirements or payments under such agreements of approximately $84 million as of September 30, 2012. The amount of collateral required to be posted for derivative agreements is also dependent on the fair value of the derivative positions as of the balance sheet date. For additional information regarding the potential impacts of a ratings downgrade on our derivative agreements see Note 14 to the Unaudited Interim Consolidated Financial Statements. In addition, a ratings downgrade by A.M. Best to “A-” for our domestic life insurance companies would require Prudential Insurance to post a letter of credit in the amount of approximately $1.7 billion, based on the level of statutory reserves related to the variable annuity business acquired from Allstate, that we estimate would result in annual cash outflows of approximately $15 million, or collateral posting in the form of cash or securities to be held in a trust. We believe that the posting of such collateral would not be a material liquidity event for Prudential Insurance.

Rating agencies use an “outlook” statement for both industry sectors and individual companies. For an industry sector, a stable outlook generally implies that over the next 12-18 months the rating agency expects ratings to remain unchanged among companies in the sector. Currently, A.M. Best, S&P and Fitch all have the U.S. life insurance industry on stable outlook. Moody’s has the U.S. life insurance industry on negative outlook. For a particular company, an outlook generally indicates a medium- or long-term trend (generally six months to two years) in credit fundamentals, which if continued, may lead to a rating change. These indicators are not necessarily a precursor of a rating change nor do they preclude a rating agency from changing a rating at any time without notice. Currently, Moody’s has all of the Company’s ratings on positive outlook; A.M. Best and Fitch have all of the Company’s ratings on stable outlook; and S&P has the ratings of our U.S.-domiciled entities on stable outlook and the ratings of The Prudential Life Insurance Company Ltd. and Gibraltar Life Insurance Company Ltd. on negative outlook as part of S&P’s decision to put the sovereign debt ratings of Japan on negative outlook.

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In view of the difficulties experienced recently by many financial institutions, the rating agencies have heightened the level of scrutiny that they apply to such institutions, increased the frequency and scope of their credit reviews, requested additional information from the companies that they rate, and may adjust upward the capital and other requirements employed in the rating agency models for maintenance of certain ratings levels, such as the financial strength ratings currently held by our life insurance subsidiaries. In addition, actions we might take to access third party financing or to realign our capital structure may in turn cause rating agencies to reevaluate our ratings.

The following is a summary of the significant changes or actions in our ratings and rating outlooks that have occurred from the beginning of 2012 through the date of this filing.

On January 4, 2012, Moody’s affirmed the financial strength rating of Gibraltar Life Insurance Company, Ltd at “A2.” At the same time, Moody’s withdrew the “A2” financial strength rating of AIG Edison Life Insurance Company due to its merger with Gibraltar Life Insurance Company, Ltd.

On January 5, 2012, S&P withdrew the financial strength and long-term counterparty ratings of AIG Edison Life Insurance Company due to its merger with Gibraltar Life Insurance Company, Ltd.

On February 16, 2012, at the request of the Company, Moody’s withdrew the “A2” financial strength rating of Gibraltar Life Insurance Company, Ltd.

On April 19, 2012, Fitch affirmed the long-term senior debt rating of Prudential Financial at “BBB+” and the financial strength ratings of our life insurance subsidiaries at “A+.”

On June 12, 2012, A.M. Best affirmed the long-term senior debt rating of Prudential Financial at “a-” and the financial strength ratings of our life insurance subsidiaries at “A+.”

On July 24, 2012, Moody’s affirmed the long-term senior debt rating of Prudential Financial at “Baa2” and the financial strength ratings of our life insurance subsidiaries at “A2.”

On July 26, 2012, S&P affirmed the long-term senior debt rating of Prudential Financial at “A” and the financial strength ratings of our life insurance subsidiaries at “AA-.”

Off-Balance Sheet Arrangements

Guarantees and Other Contingencies

In the course of our business, we provide certain guarantees and indemnities to third parties pursuant to whom we may be contingently required to make payments now or in the future. See “Commitments and Guarantees” within Note 15 to the Unaudited Interim Consolidated Financial Statements for additional information.

Other Contingent Commitments

We also have other commitments, some of which are contingent upon events or circumstances not under our control, including those at the discretion of our counterparties. See “Commitments and Guarantees” within Note 15 to the Unaudited Interim Consolidated Financial Statements for additional information regarding these commitments. For further discussion of certain of these commitments that relate to our separate accounts, also see “—Liquidity and Capital Resources of Subsidiaries—Asset Management Subsidiaries.”

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Other Off-Balance Sheet Arrangements

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the risk of change in the value of financial instruments as a result of absolute or relative changes in interest rates, foreign currency exchange rates, equity prices or commodity prices. To varying degrees, the investment and trading activities supporting all of our products and services generate exposure to market risk. The market risk incurred and our strategies for managing this risk vary by product. There have been no material changes in our market risk exposures from December 31, 2011, a description of which may be found in our Annual Report on Form 10-K, for the year ended December 31, 2011, Item 7A, “Quantitative and Qualitative Disclosures about Market Risk”, filed with the Securities and Exchange Commission. See Item 1A, “Risk Factors” included in the Annual Report on Form 10-K for the year ended December 31, 2011 for a discussion of how the difficult conditions in the financial markets and the economy generally may materially adversely affect our business and results of our operations.

ITEM 4. CONTROLS AND PROCEDURES

In order to ensure that the information we must disclose in our filings with the SEC is recorded, processed, summarized, and reported on a timely basis, the Company’s management, including our Chief Executive Officer and Chief Financial Officer, have reviewed and evaluated the effectiveness of our disclosure controls and procedures, as defined in Exchange Act Rule 13a-15(e), as of September 30, 2012. Based on such evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of September 30, 2012, our disclosure controls and procedures were effective. No change in our internal control over financial reporting, as defined in Exchange Act Rule 13a-15(f), occurred during the quarter ended September 30, 2012, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are subject to legal and regulatory actions in the ordinary course of our businesses, including class action lawsuits. Our pending legal and regulatory actions include proceedings specific to us and proceedings generally applicable to business practices in the industries in which we operate, including in both cases, businesses that have either been divested or placed in wind-down status. We are also subject to litigation arising out of our general business activities, such as our investments, contracts, leases and labor and employment relationships, including claims of discrimination and harassment. In some of our pending legal and regulatory actions, parties are seeking large and/or indeterminate amounts, including punitive or exemplary damages.

For additional information regarding our litigation and regulatory matters accrual methodology and our estimated range of reasonably possible losses in excess of accruals established, as well as additional discussion on our litigation and regulatory matters referred to below, see Note 15 to the Unaudited Interim Consolidated Financial Statements included herein.

Following is a discussion of recent material developments concerning our legal and regulatory proceedings:

In October 2012, a shareholder derivative lawsuit, *Stephen Silverman, Derivatively on Behalf of Prudential Financial, Inc. v. John R. Strangfeld, et. al.*, was filed in the United States District Court for the District of New Jersey, alleging breaches of fiduciary duties, waste of corporate assets and unjust enrichment by certain senior officers and directors. The complaint names as defendants the Company’s Chief Executive Officer, the Chief Financial Officer, the Principal Accounting Officer, the Company’s Board of Directors and a former Director. The complaint alleges that the defendants made false and misleading statements regarding the Company’s current and future financial condition based on, among other things, the alleged failure to disclose: (i) potential liability for benefits that should either have been paid to policyholders or their beneficiaries, or escheated to applicable states; and (ii) the extent of the Company’s exposure for alleged state and federal law violations concerning the settlement of claims and the escheatment of unclaimed property. The complaint seeks an undetermined amount of damages, attorneys’ fees and costs, and equitable relief including a direction for the Company to reform and improve its corporate governance and internal procedures to comply with applicable laws.

In October 2012, the Board of Directors received a shareholder demand letter (the “Demand”), containing allegations of wrongdoing similar to those alleged in the *Silverman* complaint. The Demand alleges that the Company’s Senior Management: (i) breached their fiduciary duties of loyalty and good faith in connection with the management, operation and oversight of the Company’s business; (ii) breached their fiduciary duty of good faith to establish and maintain adequate internal controls; and (iii) breached their fiduciary duties by disseminating false, misleading and/or incomplete information, all in connection with the Company’s alleged failure to use the SSDMF and to pay beneficiaries and escheat funds to states. The Demand requests that the Board of Directors: (a) undertake an independent internal investigation into Senior Management’s violations of New Jersey and/or federal law; and (b) commence a civil action against each member of Senior Management to recover for the benefit of the Company the amount of damages sustained by the Company as a result of the alleged breaches described above.

In September 2012, the State of West Virginia, through its State Treasurer, filed a lawsuit, *State of West Virginia ex. Rel. John D. Perdue v. Prudential Insurance Company of America*, in the Circuit Court of Putnam County, West Virginia. The complaint alleges violations of the West Virginia Uniform Unclaimed Property Fund Act by failing to properly identify and report all unclaimed insurance policy proceeds which should either be paid to beneficiaries or escheated to West Virginia. The complaint seeks to examine the records of Prudential Insurance to determine compliance with the West Virginia Uniform Unclaimed Property Fund Act, and to assess penalties and costs in an undetermined amount.

In September 2012, the complaint filed in *Total Asset Recovery Services v. Met Life Inc, et al., Prudential Financial, Inc., The Prudential Insurance Company of America, and Prudential Holdings, LLC*, filed in the Circuit Court of Cook County, Illinois, was withdrawn without prejudice.

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In August 2012, in the matter of *In re Prudential Insurance Company of America SGLI/VGLI Contract Litigation* the court denied plaintiffs’ class certification motion without prejudice pending, the filing of summary judgment motions on the issue of whether plaintiffs sustained an actual injury. In October 2012, the parties filed their summary judgment motions.

In August 2012, a purported class action lawsuit, *City of Sterling Heights General Employees’ Retirement System v. Prudential Financial, Inc., et al.*, was filed in the United States District Court for the District of New Jersey, alleging violations of federal securities law. The complaint names as defendants the Company’s Chief Executive Officer, the Chief Financial Officer, the Principal Accounting Officer and certain Company Board of Directors. The complaint alleges that knowingly false and misleading statements were made regarding the Company’s current and future financial condition based on, among other things, the alleged failure to disclose: (i) potential liability for benefits that should either have been paid to policyholders or their beneficiaries, or escheated to applicable states; and (ii) the extent of the Company’s exposure for alleged state and federal law violations concerning the settlement of claims and the escheatment of unclaimed property. The complaint seeks an undetermined amount of damages, interest, attorneys’ fees and costs.

In August 2012, the Company filed four additional actions in New Jersey state court captioned *The Prudential Insurance Company of America, et al.* v. *Nomura Securities International, Inc., et al.*, *The Prudential Insurance Company of America, et al.* v. *Barclays Bank PLC, et al,, The Prudential Insurance Company of America, et al.* v. *Goldman Sachs & Company, et al.* and *The Prudential Insurance Company of America, et al.* v. *RBS Financial Products, Inc., et al.* to recover damages attributable to Company and affiliate entities’ and funds’ investments in residential mortgage-backed securities.

In June 2012, in the matter of *Lederman v. Prudential Financial, Inc., et al,* the court granted summary judgment against an additional plaintiff reducing to 39 the number of plaintiffs asserting claims against the Company.

Our litigation and regulatory matters are subject to many uncertainties, and given their complexity and scope, their outcome cannot be predicted. It is possible that our results of operations or cash flow in a particular quarterly or annual period could be materially affected by an ultimate unfavorable resolution of pending litigation or regulatory matters depending, in part, upon the results of operations or cash flow for such period. In light of the unpredictability of the Company’s litigation and regulatory matters, it is also possible that in certain cases an ultimate unfavorable resolution of one or more pending litigation or regulatory matters could have a material adverse effect on our financial position. We believe, however, that, based on information currently known to us, the ultimate outcome of all pending litigation and regulatory matters, after consideration of applicable reserves and rights to indemnification, is not likely to have a material adverse effect on our financial position.

ITEM 1A. RISK FACTORS

You should carefully consider the risks described under “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2011 (“2011 Form 10-K”). These risks could materially affect our business, results of operations or financial condition, cause the trading price of our Common Stock to decline materially or cause our actual results to differ materially from those expected or those expressed in any forward looking statements made by or on behalf of the Company. These risks are not exclusive, and additional risks to which we are subject include, but are not limited to, the factors mentioned under “Forward-Looking Statements” above and the risks of our businesses described elsewhere in this Quarterly Report on Form 10-Q.

The risk factor contained in our 2011 Form 10-K titled “The enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act will subject us to substantial additional federal regulation and we cannot predict the effect on our business, results of operations, cash flows or financial condition” is hereby updated to note that on October 19, 2012, Prudential Financial received notice that it is under consideration by the Financial Stability Oversight Council for designation as a non-bank financial company to be subject to stricter prudential regulatory standards and supervision by the Board of Governors of the Federal Reserve System pursuant to the Dodd-Frank Act. For additional information on this notice of consideration by the Financial Stability Oversight Council, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Executive Summary.”

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ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(c) The following table provides information about purchases by the Company during the quarter ended September 30, 2012, of its Common Stock:

Period	Total Number of Shares Purchased(1)(2)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program(2)	Approximate Dollar Value of Shares that May Yet be Purchased under the Program
July 1, 2012 through July 31, 2012	5,681	$ 49.09	—	
August 1, 2012 through August 31, 2012	2,330	$ 53.95	—	
September 1, 2012 through September 30, 2012	2,690,471	$ 55.77	2,689,857	
Total	2,698,482	$ 55.75	2,689,857	$ 850,000,000

(1) Includes shares of Common Stock withheld from participants for income tax withholding purposes whose shares of restricted stock units vested during the period. Restricted stock units were issued to participants pursuant to the Prudential Financial, Inc. Omnibus Incentive Plan that was adopted by the Company’s Board of Directors in March 2003 (as subsequently amended and restated).

(2) In June 2012, Prudential Financial’s Board of Directors authorized the Company to repurchase at management’s discretion up to $1.0 billion of its outstanding Common Stock through June 2013.

ITEM 6. EXHIBITS

10.1	First Amendment to The Prudential Insurance Company of America Deferred Compensation Plan, effective October 5, 2012.*
12.1	Statement of Ratio of Earnings to Fixed Charges.
31.1	Section 302 Certification of the Chief Executive Officer.
31.2	Section 302 Certification of the Chief Financial Officer.
32.1	Section 906 Certification of the Chief Executive Officer.
32.2	Section 906 Certification of the Chief Financial Officer.

101.INS - XBRL	Instance Document.
101.SCH - XBRL	Taxonomy Extension Schema Document.
101.CAL - XBRL	Taxonomy Extension Calculation Linkbase Document.
101.LAB - XBRL	Taxonomy Extension Label Linkbase Document.
101.PRE - XBRL	Taxonomy Extension Presentation Linkbase Document.
101.DEF - XBRL	Taxonomy Extension Definition Linkbase Document.

* This exhibit is a management contract or compensatory plan or arrangement.

Prudential Financial, Inc. will furnish upon request a copy of any exhibit listed above upon the payment of a reasonable fee covering the expense of furnishing the copy. Requests should be directed to:

Shareholder Services

Prudential Financial, Inc.

751 Broad Street, 21st Floor

Newark, New Jersey 07102

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Prudential Financial, Inc.

By: /s/ Richard J. Carbone

Richard J. Carbone
Executive Vice President and Chief Financial Officer

(Authorized signatory and principal financial officer)

Date: November 8, 2012

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EXHIBIT INDEX

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