PRUDENTIAL FINANCIAL INC
Form 10-K
February 15, 2019
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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FORM 10-K
ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2018
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM TO
COMMISSION FILE NUMBER 001-16707

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Prudential Financial, Inc.
(Exact Name of Registrant as Specified in its Charter)

| New Jersey | 22-3703799 |
|---|---|
| (State or Other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification Number) |

751 Broad Street
Newark, New Jersey 07102
(973) 802-6000
(Address and Telephone Number of Registrant's Principal Executive Offices)

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

| Title of Each Class | Name of Each Exchange on Which Registered |
|---|---|
| Common Stock, Par Value $.01 | New York Stock Exchange |
| 5.625% Junior Subordinated Notes | New York Stock Exchange |

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT: NONE
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of the Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes x No ¨
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨ Emerging growth company ¨

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

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

As of June 30, 2018, the aggregate market value of the registrant’s Common Stock (par value $0.01) held by non-affiliates of the registrant was $39.06 billion and 418 million shares of the Common Stock were outstanding. As of January 31, 2019, 409 million shares of the registrant’s Common Stock (par value $0.01) were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this Form 10-K incorporates by reference certain information from the Registrant’s Definitive Proxy Statement for the Annual Meeting of Shareholders to be held on May 14, 2019, to be filed by the Registrant with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the year ended December 31, 2018.

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Forward-Looking Statements

Certain of the statements included in this Annual Report on Form 10-K constitute forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. Words such as "expects," "believes," "anticipates," "includes," "plans," "assumes," "estimates," "projects," "intends," "should," "will," "shall" or variations of such generally part of forward-looking statements. Forward-looking statements are made based on management's current expectations and beliefs concerning future developments and their potential effects upon Prudential Financial, Inc. and its subsidiaries. There can be no assurance that future developments affecting Prudential Financial, Inc. and its subsidiaries will be those anticipated by management. These forward-looking statements are not a guarantee of future performance and involve risks and uncertainties, and there are certain important factors that could cause actual results to differ, possibly materially, from expectations or estimates reflected in such forward-looking statements, including, among others: (1) losses on investments or financial contracts due to deterioration in credit quality or value, or counterparty default; (2) losses on insurance products due to mortality experience, morbidity experience or policyholder behavior experience that differs significantly from our expectations when we price our products; (3) changes in interest rates, equity prices and foreign currency exchange rates that may (a) adversely impact the profitability of our products, the value of separate accounts supporting these products or the value of assets we manage, (b) result in losses on derivatives we use to hedge risk or increase collateral posting requirements and (c) limit opportunities to invest at appropriate returns; (4) guarantees within certain of our products which are market sensitive and may decrease our earnings or increase the volatility of our results of operations or financial position; (5)

liquidity needs resulting from (a) derivative collateral market exposure, (b) asset/liability mismatches, (c) the lack of available funding in the financial markets or (d) unexpected cash demands due to severe mortality calamity or lapse events; (6) financial or customer losses, or regulatory and legal actions, due to inadequate or failed processes or systems, external events and human error or misconduct such as (a) disruption of our systems and data, (b) an information security breach, (c) a failure to protect the privacy of sensitive data or (d) reliance on third-parties; (7) changes in the regulatory landscape, including related to (a) financial sector regulatory reform, (b) changes in tax laws, (c) fiduciary rules and other standards of care, (d) U.S. state insurance laws and developments regarding group-wide supervision, capital and reserves, (e) insurer capital standards outside the U.S. and (f) privacy and cybersecurity regulation; (8) technological changes which may adversely impact companies in our investment portfolio or cause insurance experience to deviate from our assumptions; (9) ratings downgrades; (10) market conditions that may adversely affect the sales or persistency of our products; (11) competition; and (12) reputational damage. Prudential Financial, Inc. does not undertake to update any particular forward-looking statement included in this document. See "Risk Factors" included in this Annual Report on Form 10-K for discussion of certain risks relating to our businesses and investment in our securities.

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Throughout this Annual Report on Form 10-K, "Prudential Financial" and the "Registrant" refer to Prudential Financial, Inc., the ultimate holding company for all of our companies. "Prudential Insurance" refers to The Prudential Insurance Company of America. "Prudential," the "Company," "we" and "our" refer to our consolidated operations.

# PART I

## ITEM 1. BUSINESS

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## Overview

Prudential Financial, Inc., a financial services leader with approximately $1.377 trillion of assets under management as of December 31, 2018, 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 products and services, mutual funds and investment management. We offer these products and services to individual and institutional customers through proprietary and third-party distribution networks. Our principal executive offices are located in Newark, New Jersey, and our common stock is publicly traded on the New York Stock Exchange under the ticker symbol “PRU”.

On December 18, 2001, Prudential Insurance converted from a mutual life insurance company owned by its policyholders to a stock life insurance company and became a wholly-owned subsidiary of Prudential Financial. The demutualization was carried out under Prudential Insurance’s Plan of Reorganization, which required us to establish and operate a regulatory mechanism known as the “Closed Block.” The Closed Block includes certain in-force participating insurance and annuity products and corresponding assets that are used for the payment of benefits and policyholders’ dividends on these products, as well as certain related assets and liabilities.

Our principal operations are comprised of five divisions, which together encompass seven segments, and our Corporate and Other operations. The PGIM division is comprised of our PGIM segment (formerly named the “Investment Management” segment). The U.S. Workplace Solutions division consists of our Retirement and Group Insurance segments. The U.S. Individual Solutions division consists of our Individual Annuities and Individual Life segments. The International Insurance division consists of our International Insurance segment, and the Closed Block division consists of our Closed Block segment. Our Corporate and Other operations include corporate items and initiatives that are not allocated to business segments and businesses that have been or will be divested or placed in run-off. See Note 21 to the Consolidated Financial Statements for revenues, income and loss, and total assets by segment.

Our strategy centers on our mix of high-quality protection, retirement and investment management businesses which creates growth potential due to earnings diversification and the opportunity to provide customers with integrated cross-business solutions, as well as capital benefits from a balanced risk profile. We are well positioned to meet the needs of customers and tap into significant market opportunities through our U.S. Financial Wellness businesses (represented by our U.S. Workplace Solutions and U.S. Individual Solutions Divisions), PGIM (our investment management business) and our International Insurance business. We see an opportunity to address the evolving needs of individual customers, workplace clients, and society at large through our increasingly important financial wellness solutions. We possess the key components to execute on this strategy, including a workplace platform covering twenty million individuals; solutions that cover protection, retirement, savings, income, and investment needs; and a customer-centric approach with different ways to engage with our clients through multiple channels such as meeting with one of our financial advisors, calling or video-conferencing with an advisor, or interacting with us in a purely digital manner. Our goal is to meet our customers’ needs when, where and how they want. By leveraging technology and our scale, we aim to significantly expand the addressable market, build deeper and longer-lasting relationships with customers and clients, and make a meaningful difference in the financial wellness of their lives.

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PGIM Segment

Provides asset management services related to public and private fixed income, public equity and real estate, commercial mortgage origination and servicing, and mutual funds and other retail services to institutional, private and sub-advisory clients (including mutual funds), insurance company separate accounts, government sponsored entities (e.g. Fannie Mae, the Federal Housing Administration and Freddie Mac) and our general account.

Products

Our products and services are offered through the following eight businesses:

- PGIM Fixed Income - provides global active asset management services across all public fixed income markets ranging from core conservative to relative value hedge fund strategies.
- Jennison Associates - provides active fundamental public equity and fixed income asset management services across an array of high-quality fixed income and growth, value, blend, global and specialty equity strategies.
- QMA - provides equity and global multi-asset solutions with a quantitative investing approach.
- Prudential Capital Group - provides private corporate financing across the risk spectrum including investment grade, high yield and mezzanine, and offers a variety of products to its investors.
- PGIM Real Estate Finance - provides commercial mortgage origination and asset management services.
- PGIM Real Estate - provides a broad range of public and private real estate equity investment services utilizing deep knowledge of local and regional markets.
- PGIM Investments - develops, distributes and services investment management products primarily utilizing PGIM’s proprietary asset management expertise in the U.S. and European retail markets offering a suite of retail investment products covering a wide array of investment styles and objectives.
- PGIM Global Partners - operates an asset management business in Taiwan and has interests in asset management operating joint ventures in China, India and Italy. Each of these businesses offers mutual funds and serves individual and institutional investors and clients.

We also make seed and co-investments to support the creation and management of funds offered to third-party investors. Other strategic

Marketing and Distribution

We primarily distribute products through the following channels:

- Institutional

Proprietary sales force of each PGIM business with independent marketing and client service teams.

PGIM's Institutional Relationship Group, which develops relationships with and introduces PGIM's broad capabilities to large institutions globally.

Institutional asset management services through the Retirement Segment.

- Retail

Assets under management from distribution channels associated with other Prudential business segments.

Third-party networks and product manufacturers/distributors who include our investment options in their products and platforms.

Licensed sales professionals within Prudential Advisors, Prudential’s proprietary nationwide sales organization.

- General account

Provide investment management services across a broad array of asset classes for

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| 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). We also make loans to, and guarantee obligations of, our managed funds that are secured by equity commitments from investors or assets of the funds. | our general account. |

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PGIM Segment (Continued)

Revenues and Profitability

Our revenues primarily come from:

- Asset management fees which are typically calculated based upon a percentage of assets under management. In certain asset management arrangements, we also receive performance-based incentive fees when the return on the managed assets exceeds certain benchmark returns or other performance targets.
- Transaction fees earned as a percentage of the transaction price associated with the sale or purchase of assets in certain funds, primarily related to real estate and private fixed income.
- Investment returns from strategic investing.
- Revenues from commercial mortgage origination and servicing.

Our profitability is substantially impacted by:

- Macro market movement (e.g. interest rates and equity market performance).
- Our ability to achieve investment returns above the target benchmarks.
- Our ability to attract and retain customer investments.

Competition

We compete with numerous asset managers and other financial institutions. For our investment management products, we compete based on a number of factors, including investment performance, strategy and process, talent, organizational stability and client relationships.

We offer products across multiple asset classes, with specialized investment teams that employ approaches designed to add value in each product area or asset class. Our organizational stability and robust institutional and retail businesses have helped attract and retain talent critical to delivering investment results for clients. Our private placement and commercial mortgage businesses compete based on price, terms, execution and the strength of our relationship with the borrower.

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Retirement Segment

Provides retirement investment and income products and services to retirement plan sponsors in the public, private and not-for-profit sectors.

Products

Full Service

- A broad range of products and services to assist in the design, delivery and administration of defined contribution, defined benefit and non-qualified retirement plans.
- Recordkeeping and administrative services, actuarial advisory services, tailored participant education and communication services, comprehensive investment offerings and consulting services to assist retirement plan sponsors in managing fiduciary obligations.
- Investment products including a variety of general and separate account stable value products, other fee-based products through which customer funds are held in separate accounts, retail mutual funds, institutional funds or bank collective trusts advised by affiliated and non-affiliated investment managers, as well as synthetic guaranteed investment contracts, and guaranteed minimum withdrawal benefit products.

Institutional Investment Products

- Payout Annuities: products that provide a predictable source of monthly income, generally for the life of the participant

Pension risk transfer - non-participating group annuity insurance contracts issued to pension plan sponsors under which we assume all investment and actuarial risk associated with a group of specified participants within a plan in return for a premium typically paid as a lump-sum at inception.

Pension risk transfer - longevity reinsurance contracts from which we earn a fee for assuming the longevity risk of pension plans that have been insured by third-parties. Premiums for these products are typically paid over the duration of the contract as opposed to a lump-sum at inception.

Other products including structured settlements, voluntary income products and other group annuities.

Products (Continued)

- Stable Value: products where our obligations are backed by our general account, and we bear some or all of the investment and asset-liability management risk, depending on the product.

Investment-only products - These products are for use in institutional capital markets and qualified plans primarily including fee-based wraps through which customers' funds are held in a client-owned trust and investment results pass through to the customer. We earn fee revenue by providing a minimum interest rate guarantee backed by the general account.

Guaranteed investment contracts and funding agreements - These products contain an obligation to pay interest at a specified rate and to repay principal at maturity or following contract termination.

General Account and Separate Account Stable Value Products - In general, these products contain an obligation to pay interest at a specified rate for a specified period of time and to repay account balances over time, or market value upon contract termination. These products are either fully or partially participating, with annual or semi-annual rate resets subject to certain contractual minimums, giving effect to previous investment experience and other factors, depending on the products.

Marketing and Distribution

We primarily distribute products through the following channels:

Full Service

- Proprietary sales and support teams
- Third-party financial advisors, brokers, benefits consultants, and investment consultants
- Direct to plan sponsors

Institutional Investment Products

- Pension risk transfer through actuarial consultants and third-party brokers.

- Structured settlements through third-party specialized brokers.
- Voluntary income products and other group annuities through the defined contribution portion of our full service business and direct to plan sponsors.
- Stable value products through proprietary sales force and third-party intermediaries.

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Retirement Segment (Continued)

Underwriting and Pricing

Our revenues primarily come in the form of:

- Premiums associated with insurance and reinsurance contracts and our payout annuities.
- Policy charges and fee income associated with recordkeeping and other administrative services, and investment products (including fee-based stable value) that we offer. Policy charges and fees are primarily based on account values and/or number of participants.
- Investment income (which contributes to the net spread over interest credited on certain stable value products and related expenses.)

Our profitability is substantially impacted by our ability to appropriately price our products. We price our products based on:

- Pricing models that consider the investment environment and our risk, fees, expenses and profitability targets for our full service and institutional investment products.

For products within our payout annuity area, our models also use assumptions for mortality and, if pertinent, early retirement risks. These assumptions may be less predictable in certain markets, and deviations in actual experience from pricing assumptions could affect the profitability of these products.

For our investment-only stable value wrap product, our pricing risk is mitigated by several features:

under the contracts, we have the ability to periodically reset the crediting rates, subject to a 0% minimum floor, as well as the ability to increase fees;

generally, the contracts allow participants to withdraw funds at book value, while contractholder withdrawals occur at market value immediately or at book value over time; and

our obligation is limited to payments that are in excess of the fund value.

Competition

We compete with other large, well-established insurance companies, asset managers, recordkeepers and diversified financial institutions.

Full Service - we compete primarily based on:

- pricing
- the breadth of our service and investment offerings
- the expertise of our employees
- investment performance
- our ability to offer product features to meet the retirement income needs of our clients

While we continue to have heightened pricing pressures (driven by competition, contractual limits on fee income, the influence of intermediaries and regulations requiring more standard and consistent fee disclosures across industry providers), this business has experienced strong persistency in recent years.

Institutional Investment Products - we compete primarily based on:

- our pricing
- structuring capabilities
- our ability to offer innovative product solutions and successfully execute large-scale transactions

Sales of institutional investment products are affected by competitive factors such as:

- investment performance
- company credit and financial strength ratings
- product design
- marketplace visibility
- distribution capabilities
- fees
- crediting rates

- customer service

We are a leader in providing innovative pension risk management solutions to plan sponsors and in the stable value wrap market. We believe the pension risk transfer market continues to offer attractive opportunities that are aligned with our expertise.

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Group Insurance Segment

Provides a full range of group life, long-term and short-term group disability, and group corporate-, bank- and trust-owned life insurance in the U.S. primarily to institutional clients for use in connection with employee plans and affinity groups. Also sells accidental death and dismemberment and other ancillary coverages, and provides plan administrative services in connection with our insurance coverages.

Products

Group Life Insurance

- Employer-paid and employee-paid coverages for term life insurance, group universal life, group variable universal life, basic and voluntary accidental death and dismemberment insurance, critical illness and accident insurance.

- Many of our employee-paid coverages allow employees to retain their coverage when they change employers or retire, and we offer waiver of premium coverage where required premiums are waived in the event the insured suffers a qualifying disability.

- Group corporate-, bank- and trust-owned life insurance products in the form of group variable life insurance contracts utilizing separate accounts. These products are typically used by large corporations to fund deferred compensation plans and benefit plans for retired employees.

Group Disability Insurance

- Short-term and long-term group disability insurance which protects against loss of wages due to illness or injury. Short-term disability generally provides weekly benefits for three to six months while long-term disability benefits are typically paid monthly, following a waiting period and generally continue until the insured returns to work or reaches normal retirement age.

- Plan administration and absence management services.

Marketing and Distribution

We primarily distribute products through a proprietary sales force organized around market segments in conjunction with employee benefit brokers and consultants.

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Group Insurance Segment (Continued)

Underwriting and Pricing

Our revenues primarily come in the form of:

- Premiums and policy charges for our group life and disability products.

- Investment income (which contributes to the net spread over interest credited on our products and related expenses).

Our profitability is substantially impacted by our ability to appropriately price our products. We price our products based on:

- Underwriting practices and rating systems that consider company, industry and/or other experience. We assess the risk profile of prospective insured groups; however, certain voluntary products or coverages may require underwriting on an individual basis. We are not obligated to accept any individual certificate application and may require a prospective insured to submit evidence of insurability.

- The expected pay-out of benefits and other costs that we calculate using assumptions for mortality and morbidity rates, interest rates and expenses, depending upon the specific product features. On many of our group policies, we provide multiple year premium rate guarantees, which can contribute to fluctuations in profitability. For certain policies with experience-rated premium return provisions, the final premium is adjusted to reflect the group policyholder's actual experience during the past year. For these policies, the group contractholder bears some of the risk, or receives some of the benefit, associated with claim experience fluctuations, thus lessening the fluctuations in profitability.

Competition

We compete with other large, well-established life and health insurance providers in mature markets. We compete primarily based on brand recognition, service capabilities, customer relationships, financial strength, range of product offerings and price. Pricing of group insurance products is reflective of the large number of competitors in the marketplace. The majority of our premiums are derived from large corporations, affinity groups or other organizations having over 5,000 insured individuals, which we refer to as the National segment. We are also seeking to grow our client base with institutions that have between 100 and 5,000 individuals, which we refer to as the Premier segment. Employee-paid coverage is important as employers attempt to control costs and shift benefit decisions and funding to employees who continue to value benefits offered at the workplace. Our profitability is dependent, in part, on the voluntary coverage marketplace, which will be affected by future employment and compensation rates.

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Individual Annuities Segment

Develops and distributes individual variable and fixed annuity products, primarily to the U.S. mass affluent (households with investable assets or annual income in excess of $100,000) and affluent (households with investable assets in excess of $250,000) markets with a focus on innovative product design and risk management strategies.

Products

We offer a variety of products to serve different retirement needs and goals.

Variable Annuities

- The Prudential Premier® Retirement Variable Annuity with Highest Daily Lifetime Income ("HDI") offers lifetime income based on the highest daily account value plus a compounded deferral credit.
- Prudential Defined Income® ("PDI") Variable Annuity provides for guaranteed lifetime withdrawal payments, but restricts contractholder investment to a single bond sub-account within the separate accounts. PDI includes a living benefit rider which provides for a specified lifetime income withdrawal rate applied to purchase payment(s) paid, subject to annual roll-up increases until lifetime withdrawals commence, but does not have a highest daily benefit feature as discussed below.
- Prudential Premier® Investment Variable Annuity ("PPI") offers tax-deferred asset accumulation, annuitization options and an optional death benefit that guarantees the contractholder's beneficiary a return of total purchase payments made to the contract, adjusted for any partial withdrawals, upon death.
- Prudential Premier® Retirement Variable Annuity with Legacy Protection Plus ("LPP") provides an optional enhanced death benefit based on the purchase payments rolling up at a preset rate on an annual basis until certain events occur, such as the death of the first owner (or annuitant if entity-owned) or the roll-up cap is reached. LPP cannot be elected together with any of the other optional living or death benefits we offer.

Fixed Annuities:

- In January 2018, the Company launched PruSecure℠, a single premium fixed index annuity, which allows the contractholder to allocate all or a portion of their account balance into an index-based strategy, such as the S&P 500. The index-based strategy provides interest or an interest component linked to, but not an investment in, the selected index, and its performance over the elected term (i.e., 1, 3 or 5 years), subject to certain contractual minimums and maximums.
- In March 2018, the Company launched Guaranteed Income For Tomorrow ("GIFT®) a deferred income annuity. Each contribution purchases increments of guaranteed lifetime income that starts on a future date chosen at issue by the owner and continues for life.
- Prudential Immediate Income Annuity ("PIIA"), a single premium immediate annuity, provides a regular stream of benefit payments. The payments are guaranteed and cannot be changed, and are higher than those guaranteed on products that provide liquidity.

Marketing and Distribution

Our distribution efforts, which are supported by a network of internal and external wholesalers, are executed through a diverse group of distributors including:

- Third-party broker-dealers
- Banks and wirehouses
- Independent financial planners
- Financial professionals, including those associated with Prudential Advisors, Prudential's proprietary nationwide sales organization
- Direct response solicitation through our Group Insurance business and online (specifically for our GIFT product)

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Individual Annuities Segment (Continued)

Underwriting and Pricing

Our revenues primarily come in the form of:

- Fee income from asset management fees, as well as service fees, representing administrative service and distribution fees from many of our proprietary and non-proprietary mutual funds. The asset management fees are determined as a percentage of the average assets of our proprietary mutual funds in our variable annuity products (net of sub-advisory expenses related to non-proprietary sub-advisors).
- Policy charges and fee income representing mortality, expense and other fees for various insurance-related options and features based on the average daily net asset value of the annuity separate accounts, account value, premium, or guaranteed value, as applicable.
- Investment income (which contributes to the net spread over interest credited on certain of our products and related expenses).

Our profitability is substantially impacted by our ability to appropriately price our products. We price our products based on:

- An evaluation of the risks assumed and consideration of applicable risk management strategies, including hedging and reinsurance costs.
- Assumptions regarding investment returns and contractholder behavior, including persistency (the probability that a contract will remain in force), benefit utilization and the timing and efficiency of withdrawals for contracts with living benefit features, as well as other assumptions.

Competition

We are among the industry's largest providers of individual annuities and we compete with other providers of retirement savings and accumulation products, including large, well-established insurance and financial services companies. We believe our competitive advantage lies primarily in our innovative product features and our risk management strategies as well as brand recognition, financial strength, the breadth of our distribution platform and our customer service capabilities.

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Individual Life Segment

Develops and distributes term life, variable life and universal life insurance products primarily to the U.S. mass middle (households with investable assets in excess of $25,000 or annual income in excess of $50,000), mass affluent (households with investable assets or annual income in excess of $100,000) and affluent (households with investable assets in excess of $250,000) with a focus on providing life insurance solutions to protect individuals, families and businesses and to support estate and wealth transfer planning.

Products

We offer a variety of products that serve different protection needs and goals.

Term Life - coverage for a specified number of years with a guaranteed tax-advantaged death benefit

- Most of our term life policies offer an income tax-free death benefit, guaranteed premiums that will stay the same during the level-premium period and access to the death benefit while the policyholder is still alive to help them if they become terminally ill.
- Most of our term life policies offer a conversion option that allows the policyholder to convert the policy into a permanent policy that can potentially cover the insured for life.

Variable Life - permanent coverage for life with potential to accumulate policy cash value based on underlying investment options

- Our variable life policies offer flexibility in how much and when the policyholder pays premiums and the potential to accumulate cash value through a choice of over 50 underlying investment options or a fixed rate option.
- We offer three types of variable life policies that, in addition to the death benefit, are tailored to prioritize different goals such as protection with moderate risk, growth with higher risk or legacy giving.

Universal Life - permanent coverage for life with the potential to accumulate policy cash value

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Marketing and Distribution

We primarily distribute products through the following two channels:

- Third-party distribution

Independent brokers

Banks and wirehouses

General agencies and producer groups

- Prudential Advisors

Prudential’s proprietary nationwide sales organization that distributes Prudential life insurance, annuities and investment products with proprietary and non-proprietary investment options as well as select insurance and investment products from other carriers.

Offers certain retail brokerage and retail investment advisory services (through our dually registered broker-dealer and investment advisor, Pruco Securities, LLC) including brokerage accounts, discretionary and non-discretionary investment advisory programs and financial planning services.

Continues to execute a solutions-oriented business model centered around client relationships, while strengthening and driving Prudential’s brand promise across the country.

Receives a market based allowance from other Prudential business segments for distributing their products which is

Our universal life policies offer flexibility in how much and when the policyholder pays premiums and the potential to accumulate cash value in an account that earns interest based on a crediting rate determined by the Company subject to contractual minimums.

- Guaranteed universal life policies provide a guarantee that the policy will remain in force when it would otherwise lapse due to insufficient cash value.

- Indexed universal life policies provide interest credited to the cash value that is linked to, but not an investment in, the S&P 500® - index performance over a 1-year period subject to certain participation rates and contractual minimums/maximums.

eliminated between the segments in consolidation.

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Individual Life Segment (Continued)

Underwriting and Pricing

Our revenues primarily come in the form of:

- Premiums that are fixed or flexible in accordance with the terms of the policies.
- Policy charges and fee income consisting of in-force policy- and/or asset-based fees.
- Investment income (which contributes to the net spread over interest credited on our products and related expenses).

Our profitability is substantially impacted by our ability to appropriately price our products. We price our products based on:

- Our assumptions of mortality and morbidity, persistency, interest rates, expenses, premium payment patterns, separate account fund performance, product generated tax deductions, as well as the level, cost and availability of financing for certain statutory reserves.

Competition

We compete with other large, well-established life insurance companies in a mature market. We compete primarily based on price, service, including the speed and ease of underwriting, distribution channel relationships, brand recognition and financial strength. Due to the large number of competitors, pricing is competitive. We periodically adjust product prices and features based on the market and our strategy, with a goal of managing the Individual Life business for steady, consistent sales growth across a balanced product portfolio and to avoid over-concentration in any one product type.

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International Insurance Segment

Develops and distributes life insurance, retirement products and certain accident and health products with fixed benefits to the mass affluent and affluent markets through our Life Planner operations in Japan, Korea, Taiwan, Brazil, Argentina and Mexico. Also provides similar products to the broad middle income and mass affluent markets across Japan, our joint ventures in Chile, Malaysia, India and Indonesia, and our strategic investment in Ghana through multiple distribution channels including banks, independent agencies and Life Consultants associated with our Gibraltar Life and Other operations.

Products

Our products are classified into the following four categories:

Life Insurance Protection Products - include various traditional whole life products that provide either level or increasing coverage, and that offer limited or lifetime premium payment options. We also offer increasing, decreasing and level benefit term insurance products that provide coverage for a specified time period, as well as protection-oriented variable universal life products. Some of these protection products are denominated in U.S. dollars and some are sold as bundled products which, in addition to death protection, include health benefits or savings elements.

Retirement Products - include retirement income products which combine insurance protection similar to term life with a lifetime income stream which commences at a predefined age, savings-oriented variable universal life products which provide a non-guaranteed return linked to an underlying investment portfolio of equity and fixed income funds selected by the customer, and endowments which provide payment of the face amount on the earlier of death or policy maturity.

Annuity Products - primarily represented by U.S. dollar- and Australian dollar-denominated fixed annuities sold by our Gibraltar Life operations in Japan, and Korean won- and U.S. dollar-denominated variable annuities sold by our Life Planner operation in Korea. Sales and surrenders of non-yen products can be sensitive to foreign currency relationships which are impacted by, among other things, the comparative interest rates in the respective countries. Most of our fixed annuity products impose a market

Marketing and Distribution

Proprietary agent models:

- Life Planners - focuses on selling protection-oriented life insurance products on a needs basis to mass affluent and affluent customers, as well as retirement-oriented products to small businesses. We believe that our recruiting and selection process, training programs and compensation packages are key to the Life Planner model and have helped our Life Planner operations achieve higher levels of agent retention, agent productivity and policy persistency.

- Life Consultants - is a proprietary distribution force for products offered by our Gibraltar Life operations. Their focus is to provide individual protection products to the broad middle income market, primarily in Japan, particularly through relationships with affinity groups. Our Life Consultant operation is based on a variable compensation plan designed to improve productivity and persistency that is similar to compensation plans in our Life Planner operations.

Third-party channels:

- Bank Distribution Channel - primarily consists of life insurance products intended to provide savings features, premature death protection and estate planning benefits as well as fixed annuity products primarily denominated in U.S. dollars and Australian dollars. We view the bank distribution channel as an adjunct to our core Life Planner and Life Consultant distribution channels. A significant portion of our sales in Japan through our bank channel distribution are derived through a single Japanese mega-bank; however, we have relationships with each of Japan’s four largest banks as well as many regional banks, and we continue to explore opportunities to expand our distribution capabilities through this channel, as appropriate.

value adjustment if the contract is not held to maturity.

Accident and Health Products - provide benefits to cover accidental death and dismemberment, hospitalization, surgeries, and cancer and other dread diseases, often sold as supplementary riders and not as stand-alone products. We also offer waiver of premium coverage where required premiums are waived in the event the customer suffers a qualifying disability.

- Independent Agency Distribution Channel - sells protection products and high cash value products for retirement benefits through the business market and also sells a variety of other products including protection, medical and fixed annuity products through the individual market. Our focus is to maintain a diverse mix of independent agency relationships including corporate agencies and other independent agencies with a balanced focus on individual and business markets.

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International Insurance Segment (Continued)

Underwriting and Pricing

Our revenues primarily come in the form of:

- Premiums that are fixed or flexible in accordance with the terms of the policies.

- Policy charges and fee income consisting of in-force policy- and/or asset-based fees.

- Investment income (which contributes to the net spread over interest credited on our products and related expenses).

Our profitability is substantially impacted by our ability to appropriately price our products. We price our products based on:

- Local regulation that is generally more restrictive for product offerings, pricing and structure than U.S. insurance regulation. Each International Insurance operation has its own underwriting department that employs variations of U.S. practices in underwriting individual policy risks. To the extent permitted by local regulation, we base premiums and policy charges for our products on expected death and morbidity benefits, surrender benefits, expenses, required reserves, interest rates, policy persistency and premium payment patterns. In setting underwriting limits, we also consider local industry standards to prevent adverse selection and to stay abreast of industry trends. In addition, we set underwriting limits together with each operation's reinsurers.

- Achieving a targeted rate of return for each country, taking into account the country-specific costs of capital, risks, and competitive environment. The profitability of our products is impacted by differences between actual mortality, morbidity, expense, and investment experience and the related assumptions used in pricing these policies. As a result, the profitability of our products can fluctuate from period to period. Changes in local tax laws may also affect profitability.

Competition

The life insurance markets in Japan and Korea are mature and pricing is competitive. Rather than competing primarily based on price, we generally compete on the basis of customer service, including our needs-based approach to selling, the quality and diversity of our distribution capabilities, and our financial strength. Demographic trends in Asia suggest an increasing opportunity for product innovation, introducing insurance products that allow for savings and income as a growing portion of the population prepares for retirement. The ability to sell through multiple and complementary distribution channels is also a competitive advantage; however, competition for sales personnel, as well as access to third-party distribution channels, is intense.

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Corporate and Other Operations

Includes corporate items and initiatives that are not allocated to our business segments and businesses that have been or will be divested or placed in run-off, except for the Closed Block. Results of the Closed Block, along with certain related assets and liabilities, are reported as the Closed Block division separately from the divested and run-off businesses included in Corporate and Other Operations.

Corporate Operations - consist primarily of: (1) capital that is not deployed in any business segment; (2) investments not allocated to business segments, including debt-financed investment portfolios, and tax credit 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) our qualified and non-qualified pension and other employee benefit plans, after allocations to business segments; (5) corporate-level activities, after allocations to business segments, including strategic expenditures, corporate governance, corporate advertising, philanthropic activities, deferred compensation, and costs related to certain contingencies and enhanced regulatory supervision; (6) certain retained obligations relating to pre-demutualization policyholders; (7) our ownership interest in a life insurance joint venture in China; (8) our Capital Protection Framework; (9) the foreign currency income hedging program used to hedge certain non-U.S. dollar denominated earnings in our International Insurance segment; (10) the impact of intercompany arrangements with our PGIM segment to translate certain non-U.S. dollar-denominated earnings at fixed currency exchange rates; and (11) transactions with and between other segments, including the elimination of intercompany transactions for consolidation purposes.

Divested and Run-off Businesses - reflect the results of businesses that have been, or will be, sold or exited, including businesses that have been placed in wind down status that do not qualify for “discontinued operations” accounting treatment under Accounting Principles Generally Accepted in the United States of America (“U.S. GAAP”). We exclude these results from our adjusted operating income. Divested and Run-off Businesses include:

- Long-Term Care: In 2012, we discontinued sales of our individual and group long-term care insurance products. We establish reserves for these products in accordance with U.S. GAAP. We use best estimate assumptions as of the most recent loss recognition date when establishing reserves for future policyholder benefits and expenses, including assumptions for morbidity, mortality, mortality improvement, persistency, expenses and interest rates. Our assumptions also include our estimate of the timing and amount of anticipated future premium rate increases and policyholder benefit reductions which will require approval by state regulatory authorities. Reserves also include claims reported but not yet paid and claims incurred but not yet reported.

- Other:
In 2018, we sold our Pramerica of Poland subsidiary.
In 2018, we entered into a definitive agreement to sell our Pramerica of Italy subsidiary subject to regulatory approvals and customary closing conditions. In February 2019, the agreement was terminated and we continue to explore strategic alternatives.
In 2018, we exited our PGIM Brazil operations including the sale of our minority interest in a Brazilian asset management joint venture.
In 2008, we announced our intention to exit our financial advisory business, which consisted of our investment in a retail securities brokerage and clearing operations joint venture which we sold on December 31, 2009. Certain expenses relating to the businesses we originally contributed to the joint venture were retained, primarily for litigation and regulatory matters.
In 2003, we sold our property and casualty insurance companies to Liberty Mutual Group (“Liberty Mutual”). We have reinsured Liberty Mutual for adverse loss development for specific property and casualty risks that they did not want to retain.

In 1993, we ceased writing hospital expense and major medical policies. For our hospital expense and major medical policies, the 1996 Health Insurance Portability and Accountability Act guarantees renewal beyond age 65. Under certain circumstances, with appropriate approvals from state regulatory authorities, we are permitted to change the premiums charged for these policies if we can demonstrate the premiums have not been sufficient to pay claims.

In the early 1990s we ceased our active engagement in the assumed life reinsurance market in the United States; however, we remain subject to mortality risk for certain assumed individual life insurance policies under the terms of the reinsurance treaties.

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Closed Block Division

In connection with the demutualization in 2001, we ceased offering domestic participating individual life insurance and annuity products, under which policyholders are eligible to receive policyholder dividends reflecting experience. The liabilities for our individual in-force participating products were segregated, together with assets to be used exclusively for the payment of benefits and policyholder dividends, expenses and taxes with respect to these products, in the Closed Block. We selected the amount of assets that were expected to generate sufficient cash flow, together with anticipated revenues from the Closed Block policies, over the life of the Closed Block to fund payments of all policyholder benefits, expenses and taxes, and to provide for the continuation of the policyholder dividend scales in effect in 2000, assuming experience underlying such scales continued. No policies sold after demutualization have been added to the Closed Block, and its in-force business is expected to decline as we pay policyholder benefits in full.

The results of the Closed Block, along with certain related assets and liabilities, comprise the Closed Block division, which is treated as a divested business under our definition of adjusted operating income and reported separately from the other divested and run-off businesses that are included in our Corporate and Other operations.

As discussed in Note 14 to the Consolidated Financial Statements, if the performance of the Closed Block is more or less favorable than we originally assumed in funding, total dividends paid to Closed Block policyholders in the future may be greater 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 experience in excess of amounts assumed may be available for distribution over time to Closed Block policyholders as part of policyholder dividends unless offset by future Closed Block experience that is less favorable than expected. This excess experience will not be available to shareholders. If the Closed Block has insufficient funds to make guaranteed policy benefit payments, such payments will be made from Prudential Insurance's assets outside of the Closed Block. A policyholder dividend obligation liability is established for any excess experience. 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 and losses, mortality experience and other factors. See Note 21 to the Consolidated Financial Statements for revenues, income and loss, and total assets of the Closed Block division.

Our strategy is to maintain the Closed Block as required by our Plan of Reorganization over the time period of its gradual diminution as policyholder benefits are paid in full. We are permitted under the Plan of Reorganization, with the prior consent of the Commissioner of Banking and Insurance for the State of New Jersey, to enter into agreements to transfer all or any part of the risks under the Closed Block policies.

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Seasonality of Key Financial Items

A majority of our reporting segments experience seasonality with respect to certain elements of their business. The following chart summarizes the key areas of seasonality by business.

| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|---|---|---|---|---|
| PGIM | | | | Other related revenues tend to be highest(1) |
| Retirement | Reserve gains tend to be highest | | PRT sales are episodic and tend to be highest in third quarter and fourth quarter | |
| Group Insurance | Mortality tends to be unfavorable | | | |
| Individual Annuities | Sales tend to be highest | | | |
| Individual Life | Mortality tends to be unfavorable | | | Sales tend to be highest |
| International Insurance | Earnings tend to be highest due to higher annual premiums | | | |
| Corporate & Other | Long-term and deferred compensation expenses tend to fluctuate with equity markets and Prudential stock price | | | |
| All Businesses | | Impact of annual assumption update(2) | | Expenses tend to be highest |

(1) Other related revenues include incentive fees, transaction fees, strategic investing results and commercial mortgage revenues.
(2) Impact of annual reviews and update of actuarial assumptions and other refinements.

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Reinsurance

We regularly enter into reinsurance agreements as either the ceding entity or the assuming entity. As a ceding entity, exposure to the risks reinsured is reduced by transferring certain rights and obligations of the underlying insurance product to a counterparty. As an assuming entity, exposure to the risks reinsured is increased by assuming certain rights and obligations of the underlying insurance products from a counterparty. We enter into reinsurance agreements as the ceding entity for a variety of reasons but primarily to reduce exposure to loss, reduce risk volatility, provide additional capacity for future growth and for capital management purposes. Under ceded reinsurance, we remain liable to the underlying policyholder if a third-party reinsurer is unable to meet its obligations. On a Company-wide basis, we evaluate the financial condition of reinsurers and monitor the concentration of counterparty risk to mitigate this exposure. We enter into reinsurance agreements as the assuming entity as part of our normal product offerings (e.g., certain pension risk transfer products in the Retirement segment) or in order to facilitate an acquisition of a block of business.

The following table summarizes our use of reinsurance in each of our insurance reporting segments.

| Segment | Primary type of reinsurance | Purpose |
|---|---|---|
| Retirement | Assumed | Assumed reinsurance as part of our longevity reinsurance pension risk transfer product and in conjunction with our 2004 acquisition of CIGNA's defined benefit and defined contribution business. |
| Group Insurance | Ceded | Ceded reinsurance on most products to limit losses from large claims, in response to client requests and for capital management purposes. |
| Individual Annuities | Ceded/Assumed | Ceded reinsurance to reduce exposure to our HDI v.3.0 variable annuity business issued between April 1, 2015 to December 31, 2016.<br>Assumed reinsurance in conjunction with our 2006 acquisition of The Allstate Corporation's ("Allstate") annuity business and internal ceded and assumed reinsurance as part of our risk and capital management activities. |
| Individual Life | Ceded/Assumed | Ceded reinsurance with both third-party reinsurers and affiliates covering a variety of products to mitigate mortality risk and for capital management purposes. On policies sold since 2000, we have reinsured a significant portion of the mortality risk assumed, with that portion varying over time depending on market factors and strategic objectives.<br>Assumed reinsurance in conjunction with our 2013 acquisition of the Hartford Life business. |
| International Insurance | Ceded | Ceded reinsurance with both third-party reinsurers and affiliates to mitigate mortality risk for certain protection products and for capital management purposes. |
| Closed Block | Ceded | Prudential Insurance reinsures substantially all of the outstanding liabilities of the Closed Block into a statutory guaranteed separate account of a wholly-owned subsidiary, Prudential Legacy Insurance Company of New Jersey ("PLIC"), primarily on a coinsurance basis. The reinsurance transaction provides a long-term and comprehensive capital framework for the Closed Block. |

Intangible and Intellectual Property

We capture and protect the innovation in our financial services products by applying for federal business method patents and implementing trade secret controls, as appropriate. We also use numerous federal, state, common law and foreign servicemarks, including in particular "Prudential", the "Prudential logo", our "Rock" symbol and "PGIM". We believe

that the value associated with many of our patents and trade secrets, and the goodwill associated with many of our servicemarks are significant competitive assets.

Since 2004, we have had an agreement with Prudential plc of the United Kingdom (“U.K.”), with whom we have no affiliation, concerning the parties’ respective rights worldwide to use the names “Prudential” and “Pru.” The agreement restricts use of the “Prudential” and “Pru” name and mark in a number of countries outside the Americas, including Europe and most parts of Asia. Where these limitations apply, we combine our “Rock” symbol with alternative word marks. We believe that these limitations do not materially affect our ability to operate or expand internationally.

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Regulation

Overview

Our businesses are subject to comprehensive regulation and supervision. The purpose of these regulations is primarily to protect our customers and the overall financial system and not necessarily our shareholders or debt holders. Many of the laws and regulations to which we are subject are regularly re-examined. Existing or future laws and regulations may become more restrictive or otherwise adversely affect our operations or profitability, increase compliance costs, or increase potential regulatory exposure. In recent years we have experienced, and expect to continue to experience, extensive changes in the laws and regulations, and regulatory frameworks applicable to our businesses in the U.S. and internationally. In particular, in October 2018 the Financial Stability Oversight Council (the "Council") rescinded the Company's designation as a non-bank financial company (a "Designated Financial Company") subject to supervision by the Board of Governors of the Federal Reserve System ("FRB") under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") as discussed below. We cannot predict how current or future initiatives will further impact existing laws, regulations and regulatory frameworks.

In our international businesses, regulations may apply heightened requirements to non-domestic companies, which can reduce our flexibility as to intercompany transactions, investments and other aspects of business operations and adversely affect our liquidity and profitability. In some instances, regulators of a particular country may impose different, or more rigorous laws and requirements than in the U.S. or other countries to protect customers or their financial system from perceived systemic risk, including regulations governing privacy, consumer protection, employee protection, corporate governance and capital adequacy. In addition, certain of our international operations face political, legal, operational and other risks that we do not face in the U.S., including the risk of discriminatory regulation, labor issues in connection with workers' associations and trade unions, nationalization or expropriation of assets, price controls and currency exchange controls or other restrictions that limit our ability to transfer funds from these operations out of the countries in which they operate or to convert local currencies we hold into U.S. dollars or other currencies. Some jurisdictions in which we operate joint ventures restrict our maximum percentage of ownership, which exposes us to additional operational, compliance, legal and joint venture partner risks and limits our array of potential remedies in the event of a breach by a partner.

The primary regulatory frameworks applicable to the Company are described further below under the following section headings:

- Dodd-Frank Wall Street Reform and Consumer Protection Act
  - Rescission of Designation
  - Initiatives Regarding Dodd-Frank and Financial Regulation
- ERISA
- Fiduciary Rules and other Standards of Care
- U.S. State Insurance Holding Company Regulation
- U.S. Insurance Operations
  - State Insurance Regulation
  - U.S. Federal and State Securities Regulation Affecting Insurance Operations
- International Insurance Regulation
- U.S. Investment and Retirement Products and Investment Management Operations
- U.S. Securities and Commodity Operations
- International Investment and Retirement Products and Investment Management Operations
- Derivatives Regulation
- Privacy and Cybersecurity Regulation

- Anti-Money Laundering and Anti-Bribery Laws
- Environmental Laws and Regulations
- Unclaimed Property Laws
- Taxation
  - U.S. Taxation
  - International Taxation
- International and Global Regulatory Initiatives

Several of our domestic and foreign regulators participate in an annual supervisory college facilitated by the New Jersey Department of Banking and Insurance ("NJDOBI"). The purpose of the supervisory college is to promote ongoing supervisory coordination, facilitate the sharing of information among regulators and enhance each regulator's understanding of the Company's risk profile. The most recent supervisory college was held in October 2018.

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Dodd-Frank Wall Street Reform and Consumer Protection Act

Rescission of Designation

As a result of the Council's rescission of the Company's Designated Financial Company status, the Company is no longer subject to supervision and examination by the FRB or to the prudential standards applicable to Designated Financial Companies under Dodd-Frank. Accordingly, the Company will no longer incur FRB supervisory fees (which totaled approximately $24 million in each of the last three years) or certain consulting and other costs associated with FRB supervision.

The Council maintains the authority to designate entities, including the Company, for FRB supervision if it determines that either (i) material financial distress at the entity, or (ii) the nature, scope, size, scale, concentration, interconnectedness, or mix of the entity's activities, could pose a threat to domestic financial stability. The Company continues to believe it does not meet the standards for designation.

Initiatives Regarding Dodd-Frank and Financial Regulation

In November 2017, the U.S. Department of the Treasury released a report titled "Financial Stability Oversight Council Designations," with recommendations on the Council's standards and processes for the designation and continued designation of Designated Financial Companies. In addition, in October 2017, the U.S. Department of the Treasury released a report titled "A Financial System That Creates Economic Opportunities - Asset Management and Insurance" which recommended, among other things, that primary federal and state regulators should focus on potential systemic risks arising from products and activities, and on implementing regulations that strengthen the asset management and insurance industries as a whole, rather than focus on an entity-based regulatory regime. The report also affirmed the role of the U.S. state-based system of insurance regulation. From time to time Congress has also introduced legislation which if enacted, would amend certain provisions of Dodd-Frank, including by requiring the Council to prioritize the use of an activities-based approach to mitigate identified systemic risks.

We cannot predict whether the Treasury reports, new legislation or other initiatives aimed at revising Dodd-Frank and regulation of the financial system will ultimately form the basis for changes to laws or regulations impacting the Company.

ERISA

The Employee Retirement Income Security Act ("ERISA") is a comprehensive federal statute that applies to U.S. employee benefit plans sponsored by private employers and labor unions. Plans subject to ERISA include pension and profit sharing plans and welfare plans, including health, life and disability plans. ERISA provisions include reporting and disclosure rules, standards of conduct that apply to plan fiduciaries and prohibitions on transactions known as "prohibited transactions," such as conflict-of-interest transactions and certain transactions between a benefit plan and a party in interest. ERISA also provides for civil and criminal penalties and enforcement. Our insurance, investment management and retirement businesses provide services to employee benefit plans subject to ERISA, including services where we may act as an ERISA fiduciary. In addition to ERISA regulation of businesses providing products and services to ERISA plans, we become subject to ERISA's prohibited transaction rules for transactions with those plans, which may affect our ability to enter transactions, or the terms on which transactions may be entered, with those plans, even in businesses unrelated to those giving rise to party in interest status.

Fiduciary Rules and Other Standards of Care

The Company and our distributors are subject to rules regarding the standard of care applicable to sales of our products and the provision of advice to our customers. In recent years, many of these rules have been revised or reexamined, as described below. We cannot predict whether any proposed or new amendments to the existing regulatory framework will ultimately become applicable to our businesses. Any new standards issued by the U.S. Department of Labor (“DOL”), the Securities and Exchange Commission (“SEC”), the National Association of Insurance Commissioners (“NAIC”) or state regulators may affect our businesses, results of operations, cash flows and financial condition.

DOL Fiduciary Rules

In June 2018 a Fifth Circuit Court of Appeals decision became effective that vacated rules issued by the DOL that redefined who would be considered a “fiduciary” for purposes of transactions with qualified plans, plan participants and Individual Retirement Accounts (“IRAs”), and generally provided that investment advice to a plan participant or IRA owner would be treated as a fiduciary activity. The rules adversely impacted sales in our annuities and retirement business and resulted in increased compliance costs prior to the rules being vacated. We cannot predict whether the DOL will issue any new fiduciary rules or what impact they would

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have on the Company.

SEC Best Interest Regulation

In April 2018, the SEC proposed a package of rulemakings and interpretative guidance that would, among other things, require broker-dealers to act in the best interest of retail customers when recommending securities transactions or investment strategies to them. The proposals would also clarify the SEC's views of the fiduciary duty that investment advisers owe to their clients. If enacted in their current form, we believe the primary impact of the proposals would be to our Individual Annuities, Retirement, PGIM and Individual Life segments and our Prudential Advisors distribution system, which we include in the results of our Individual Life segment.

U.S. State Standard of Care Regulation

The NAIC has formed an Annuity Suitability Working Group, which is developing proposed revisions to the model suitability rule applicable to the sale of annuities. Amendments to the model rule could ultimately form the basis of amendments to state insurance law suitability rules applicable to our business. In addition, certain state regulators and legislatures have adopted or are considering adopting best interest standards. For example, in July 2018, the New York State Department of Financial Services ("NY DFS") issued an amendment to its suitability regulations which will impose a best-interest standard on the sale of annuity and life insurance products in New York. The amendments are scheduled to become effective for annuity products on August 1, 2019 and for life insurance products on February 1, 2020. In addition, in October 2018 the New Jersey Bureau of Securities issued a proposal that would impose a fiduciary standard on all New Jersey investment professionals.

Japan Standard of Care Regulation

Outside the U.S., in 2017 the Japanese Financial Services Agency ("FSA") announced the "Principles of Fiduciary Duty," a set of recommended general principles for businesses to adopt when performing client related financial services. The principles have been adopted by The Prudential Life Insurance Company Ltd. ("Prudential of Japan"), Gibraltar Life, and Prudential Gibraltar Financial Life Insurance Company, Ltd. ("PGFL"). The FSA encourages voluntary adoption of these fiduciary principles as a best practice, but adoption is not required by regulation. Companies' policies regarding their fiduciary duties can be tailored based on their specific business, such as target clients and complexity of products. Once companies adopt the principles and establish a policy, they are required to implement measures to ensure their employees fulfill their fiduciary duties, and periodically assess the measures' effectiveness.

U.S. State Insurance Holding Company Regulation

We are subject to the insurance holding company laws in the states where our insurance subsidiaries are domiciled, which currently include New Jersey, Arizona, Connecticut and Indiana, or are treated as commercially domiciled, such as New York. These laws generally require each insurance company directly or indirectly owned by the holding company to register with the insurance department in the insurance company's state of domicile and to furnish annually financial and other information about the operations of companies within the holding company system, including an assessment of the group's risk management and current and future solvency position. Generally, all transactions affecting the insurers in the holding company system must be fair and reasonable and, if material, require prior notice and approval or non-disapproval by the state's insurance department.

Change of Control

Most states, including the states in which our U.S. insurance companies are domiciled, have insurance laws that require regulatory approval of a direct or indirect change of control of an insurer or an insurer's holding company.

Laws such as these that apply to us prevent any person from acquiring control of Prudential Financial or of our insurance subsidiaries unless that person has filed a statement with specified information with the insurance regulators and has obtained their prior approval. Under most states' statutes, acquiring 10% or more of the voting stock of an insurance company or its parent company is presumptively considered a change of control, although such presumption may be rebutted. Accordingly, any person who acquires 10% or more of the voting securities of Prudential Financial without the prior approval of the insurance regulators of the states in which our U.S. insurance companies are domiciled will be in violation of these states' laws and may be subject to injunctive action requiring the disposition or seizure of those securities by the relevant insurance regulator or prohibiting the voting of those securities and to other actions determined by the relevant insurance regulator. In addition, many state insurance laws require prior notification to state insurance departments of a change in control of a non-domiciliary insurance company doing business in that state.

Group-Wide Supervision



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NJDOBI acts as the group-wide supervisor of Prudential Financial pursuant to New Jersey legislation that authorizes group-wide supervision of internationally active insurance groups ("IAIGs"). The law, among other provisions, authorizes NJDOBI to examine Prudential Financial and its subsidiaries, including by ascertaining the financial condition of the insurance companies for purposes of assessing enterprise risk. In accordance with this authority, NJDOBI receives information about the Company's operations beyond those of its New Jersey domiciled insurance subsidiaries.

Additional areas of focus regarding group-wide supervision of insurance holding companies include the following:

•Group Capital Calculation. The NAIC has formed a working group to develop a U.S. group capital calculation using a risk-based capital ("RBC") aggregation methodology. In constructing the calculation, the working group is considering group capital developments undertaken by the FRB and the International Association of Insurance Supervisors ("IAIS"). The working group plans to develop a proposed calculation and begin field testing in 2019.

•Macroprudential Framework. The NAIC has established a new initiative to develop a macroprudential framework intended to: (1) improve state insurance regulators' ability to monitor and respond to the impact of external financial and economic risks on insurers; (2) better monitor and respond to risk emanating from or amplified by insurers that might be transmitted externally; and (3) increase public awareness of NAIC/state monitoring capabilities regarding macroprudential trends. As part of this initiative, the areas identified by the NAIC for potential enhancement include liquidity reporting and stress testing, resolution and recovery, capital stress testing, and counterparty exposure and concentration.

•Examination. State insurance departments conduct periodic examinations of the books and records, financial reporting, policy filings and market conduct of insurance companies domiciled in their states, generally once every three to five years. Examinations are generally carried out in cooperation with the insurance departments of other states under guidelines promulgated by the NAIC. As group-wide supervisor, NJDOBI, along with our other insurance regulators, has expanded the periodic examinations to cover Prudential and all of its subsidiaries. In June 2018, NJDOBI, along with the insurance regulators of Arizona, Connecticut and Indiana, completed their first global consolidated group-wide examination of Prudential and its subsidiaries for the five-year period ended December 31, 2016 and had no reportable findings.

We cannot predict what, if any, additional requirements and compliance costs any new group-wide standards will impose on Prudential Financial.

U.S. Insurance Operations

State insurance laws regulate all aspects of our U.S. insurance businesses, and state insurance departments in the fifty states, the District of Columbia and various U.S. territories and possessions monitor our insurance operations. Prudential Insurance is domiciled in New Jersey and its principal insurance regulatory authority is the NJDOBI. Our other U.S. insurance companies are principally regulated by the insurance departments of the states in which they are domiciled. Generally, our insurance products must be approved by the insurance regulators in the state in which they are sold. Our insurance products are substantially affected by federal and state tax laws.

State Insurance Regulation

State insurance authorities have broad administrative powers with respect to all aspects of the insurance business including: (1) licensing to transact business; (2) licensing agents; (3) admittance of assets to statutory surplus; (4) regulating premium rates for certain insurance products; (5) approving policy forms; (6) regulating unfair trade and claims practices; (7) establishing reserve requirements and solvency standards; (8) fixing maximum interest rates on

life insurance policy loans and minimum accumulation or surrender values; (9) regulating the type, amounts and valuations of investments permitted; (10) regulating reinsurance transactions, including the role of captive reinsurers; and (11) other matters.

State insurance laws and regulations require our U.S. insurance companies to file financial statements with state insurance departments everywhere they do business in accordance with accounting practices and procedures prescribed or permitted by these departments. The operations of our U.S. insurance companies and accounts are subject to examination by those departments at any time.

Financial Regulation

Dividend Payment Limitations. New Jersey insurance law and the insurance laws of the other states in which our insurance

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companies are domiciled regulate the amount of dividends that may be paid by Prudential Insurance and our other U.S. insurance companies. See Note 15 to the Consolidated Financial Statements for additional information.

Risk-Based Capital. We are subject to RBC requirements that are designed to enhance regulation of insurers' solvency. The RBC calculation, which regulators use to assess the sufficiency of an insurer's statutory capital, measures the risk characteristics of a company's assets, liabilities and certain off-balance sheet items. In general, RBC is calculated by applying factors to various asset, premium, claim, expense and reserve items. Within a given risk category, these factors are higher for those items with greater underlying risk and lower for items with lower underlying risk. Insurers that have less statutory capital than required are considered to have inadequate capital and are subject to varying degrees of regulatory action depending upon the level of capital inadequacy.

Areas of the RBC framework that have been subject to reexamination or revision include the following:

•Tax Act Changes. In June 2018, the NAIC's Capital Adequacy Task Force approved revisions to the RBC framework in respect of the Tax Cuts and Jobs Act of 2017 (the "Tax Act of 2017"). The revisions apply to our domestic life insurance companies' RBC ratios as of December 31, 2018. For a discussion of the impact of the Tax Act of 2017 and these changes on our RBC ratios, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Capital—Insurance Regulatory Capital."

•Bond Factors. The NAIC's Investment Risk-Based Capital Working Group is developing updates to the RBC factors for invested assets including expanding, for RBC purposes, the current NAIC designations from six to twenty.

•Longevity/Mortality Risk. The NAIC's Longevity Risk Subgroup of the Life Insurance and Annuities Committee and Financial Condition Committee is developing recommendations to recognize longevity risk in statutory reserves and/or risk-based capital related to annuities. The Company assumes this longevity risk primarily in its Retirement and Individual Annuities businesses. The NAIC is also developing updates to the existing mortality risk factors in RBC.

•Operational Risk. In 2018 the NAIC adopted operational risk charges that will be effective for year-end 2018 RBC formulas and is continuing to consider whether to add an explicit growth risk charge to the RBC formula. The operational risk charges are not expected to materially impact our 2018 RBC ratios given that we expect to hold statutory capital consistent with or in excess of the thresholds established through these new charges.

Due to the ongoing nature of the NAIC's activities regarding RBC, we cannot determine the ultimate timing of the proposed changes or their impact on RBC or on our financial position.

Insurance Reserves and Regulatory Capital. State insurance laws require us to analyze the adequacy of our reserves annually. The respective appointed actuaries for each of our life insurance companies must each submit an opinion that our reserves, when considered in light of the assets we hold with respect to those reserves, make adequate provision for our contractual obligations and related expenses.

The reserving framework for certain of our products has undergone reexamination and revision in recent years, including in the following areas:

•Principle-Based Reserving for Life Insurance Products. In 2016, the NAIC adopted a principle-based reserving approach for life insurance products. Principle-based reserving replaces the reserving methods for life insurance products for which the current formulaic basis for reserves may not accurately reflect the risks or costs of the liability or obligations of the insurer. The principle-based reserving approach has a three-year phase-in period. At the Company's discretion, it may be applied to new individual life business beginning as early as January 1, 2017, but must be applied for all new individual life business issued January 1, 2020 and later. The Company may select

different implementation dates for different products. Principle-based reserving will not affect reserves for policies in force prior to January 1, 2017.

The Company has introduced updated versions of several products in its individual life product portfolio in conjunction with the requirement to adopt principle-based reserving by January 1, 2020. Notably, the Company adopted principle-based reserving for its guaranteed universal life products and introduced updated versions of these products in 2017. The guaranteed universal life updated products support the principle-based statutory reserve level without the need for financing through captive reinsurance under Actuarial Guideline No. 48 (“AG 48”) or its successor, the Credit for Reinsurance Model Law and the Term and Universal Life Insurance Reserving Financing

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Model Regulation. AG 48 prescribes an actuarial method to determine the portion of the assets held to support reserves for certain term and universal life policies that must be cash and rated securities, and the portion that may be financed or supported by other assets. The Company is continuing to assess the impact of principle-based reserving on projected statutory reserve levels and product pricing for its remaining portfolio of individual life product offerings, such as term and variable life insurance.

•Variable Annuities Framework for Change. In 2018, the NAIC adopted a framework for proposed revisions to the current Actuarial Guideline No. 43 (“AG 43”) and RBC “C-3 Phase II” system applicable to variable annuities reserve and capital requirements. Proposed changes include: (i) aligning economically-focused hedge assets with liability valuations; (ii) reforming standard scenarios for AG 43 and C3 Phase II; (iii) revising asset admissibility for derivatives and deferred tax assets; and (iv) standardizing capital market assumptions and aligning total asset requirements and reserves. The NAIC will seek to implement the revised framework in 2019 with a January 1, 2020 targeted effective date and an optional three-year phase-in. The Company does not expect material impacts to target capital levels from the revised framework.

During 2016, we recaptured the risks related to our variable annuities living benefit riders and certain retirement products that were previously reinsured to our captive reinsurance company in a series of transactions we collectively refer to as the “Variable Annuities Recapture.” While we completed the Variable Annuities Recapture in advance of definitive guidance from the NAIC's Variable Annuity Issues Working Group, we believe the Variable Annuities Recapture is reasonably aligned with the key concept changes planned under the framework.

•New York Variable Annuity and Life Insurance Product Reserves. As a result of an agreement with the NY DFS regarding our reserving methodologies for certain variable annuity and life insurance products, certain of our New York licensed insurance subsidiaries hold additional statutory reserves on a New York basis, which reduces their New York statutory surplus. None of our U.S. operating insurance companies are domiciled in New York, and these changes do not impact statutory reserves reported in our insurance subsidiaries’ states of domicile, or any states other than New York, and therefore do not impact RBC ratios; however, the agreed reserve methodologies may require us to increase our additional New York statutory reserves in the future. If we were required to establish material additional reserves on a New York statutory accounting basis or post material amounts of additional collateral with respect to annuity or insurance products, our ability to deploy capital held within our U.S. domestic insurance subsidiaries for other purposes could be affected.

•Reinsurance. The NAIC’s Statutory Accounting Principles Working Group is reviewing the statutory accounting rules regarding reinsurance credit, including with respect to the risk transfer requirements for yearly renewable term reinsurance agreements. Certain changes currently under consideration could adversely impact statutory reserve credit for our yearly renewable term reinsurance related to our group life insurance business.

The NAIC’s Life Actuarial Task Force is also evaluating changes to its Valuation Manual in respect of yearly renewable term reinsurance. Certain changes currently under consideration could adversely impact statutory reserve credit for yearly renewable term reinsurance related to our individual life insurance products being reserved using a principle-based approach.

•Surplus Notes. The NAIC’s Statutory Accounting Principles Working Group is evaluating changes to the accounting rules regarding surplus notes with linked assets. This change could result in the classification of the surplus notes as debt instead of surplus and require linked assets to be treated as non-admitted assets. These changes would materially adversely impact the statutory financial position of the Company’s captive reinsurance subsidiaries that use credit-linked note structures to finance Regulation XXX and Guideline AXXX reserves.

Captive Reinsurance Companies.

We have used captive reinsurance subsidiaries to finance the portion of the statutory reserves for term and universal life policies that we consider to be non-economic. If we are unsuccessful in obtaining additional financing as a result of market conditions, regulatory changes or otherwise, this could require us to increase prices, reduce our sales of certain life products, or modify certain products, any of which could adversely affect our competitiveness, capital and financial position and results of operations. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Capital—Financing Activities—Term and Universal Life Reserve Financing" for a discussion of our life product reserves and reserve financing.

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Market Conduct Regulation

State insurance laws and regulations include numerous provisions governing the marketplace activities of insurers, including provisions governing the form and content of disclosure to consumers, illustrations, advertising, sales practices and complaint handling. State regulatory authorities generally enforce these provisions through periodic market conduct examinations.

Insurance Guaranty Association Assessments

Each state has insurance guaranty association laws under which insurers doing business in the state are members and may be assessed by state insurance guaranty associations for certain obligations of insolvent insurance companies to policyholders and claimants. Typically, states assess each member insurer in an amount related to the member insurer's proportionate share of the line of business written by all member insurers in the state. Many states offer a reimbursement of such assessments in the form of credits against future years' premium taxes. For the years ended December 31, 2018, 2017 and 2016, we paid $2.3 million, $12.6 million and $1.5 million, respectively, in assessments pursuant to state insurance guaranty association laws. The 2017 assessments reflected the Penn Treaty Network America Insurance Company insolvency, which was liquidated on March 1, 2017. While we cannot predict the amount and timing of future assessments on our U.S. insurance companies under these laws, we have established estimated reserves totaling approximately $33.4 million as of December 31, 2018, for future assessments relating to insurance companies that are currently subject to insolvency proceedings including Penn Treaty Network America Insurance Company, Executive Life of California and Lincoln Memorial Life Insurance Company.

In 2017, the NAIC approved amendments to the Life and Health Insurance Guaranty Association Model Act to address issues relating to long-term care insurance-related insolvencies. The amendments will spread costs from future long-term care insurance-related insolvencies across the entire health and life insurance industry, resulting in increased assessments for life insurers. The amended model law will become applicable to us as it is adopted by each state. Prior insolvencies will not be included under these amendments. Given our current market share of the impacted lines of business, we expect our cost related to future insolvencies, net of premium tax credits available under current state laws, would be a small percentage of the gross industry liability.

U.S. Federal and State Securities Regulation Affecting Insurance Operations

Our variable life insurance, variable annuity and mutual fund products generally are "securities" within the meaning of federal securities laws and may be required to be registered under the federal securities laws and subject to regulation by the SEC and the Financial Industry Regulatory Authority ("FINRA"). Certain of our insurance subsidiaries are subject to SEC public reporting and disclosure requirements based on offerings of these products. Federal and some state securities regulation similar to that discussed below under "—Investment Products and Investment Management Operations" and "—Securities and Commodities Regulation" affect investment advice, sales and related activities with respect to these products.

Our mutual funds, and in certain states our variable life insurance and variable annuity products, are also "securities" within the meaning of state securities laws. As securities, these products are subject to filing and certain other requirements. Also, sales activities with respect to these products generally are subject to state securities regulation. Such regulation may affect investment advice, sales and related activities for these products.

Federal Insurance Office

Dodd-Frank established a Federal Insurance Office ("FIO") within the Department of the Treasury headed by a director appointed by the Secretary of the Treasury. While the FIO does not have general supervisory or regulatory authority

over the business of insurance, the FIO director performs various functions with respect to insurance, including serving as a non-voting member of the Council, monitoring the insurance sector and representing the U.S. on prudential aspects of international insurance matters, including at the IAIS.

International Insurance Regulation

Our international insurance operations are principally supervised by regulatory authorities in the jurisdictions in which they operate, including the Japanese Ministry of Finance and the Japanese FSA, the financial services regulator in Japan. In addition to Japan, we operate insurance companies in Argentina, Bermuda, Brazil, Italy, Korea, Mexico and Taiwan, and have insurance operations in China, India, Indonesia and Malaysia through joint ventures, and in Ghana through a strategic investment. The insurance regulatory bodies for these businesses typically oversee such issues as: (1) company licensing; (2) the licensing of insurance sales staff; (3) insurance product approvals; (4) sales practices; (5) claims payment practices; (6) permissible investments; (7) solvency and capital adequacy; and (8) insurance reserves, among other items. In some jurisdictions, for certain products,

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regulators will also mandate premium rates (or components of pricing) or minimum guaranteed interest rates. Periodic examinations of insurance company books and records, financial reporting requirements, market conduct examinations and policy filing requirements are among the techniques used by these regulators to supervise our non-U.S. insurance businesses. Finally, insurance regulatory authorities in the various jurisdictions in which our insurance companies are domiciled, including Japan, must approve any change of control of Prudential Financial or the insurance companies organized under their laws.

Solvency Regulation

In order to monitor insurers' solvency, regulatory authorities in the jurisdictions in which we operate outside the U.S. generally establish some form of minimum solvency requirements for insurance companies, similar in concept to the RBC ratios that are employed by U.S. insurance regulators. These solvency ratios are used by regulators to assess the sufficiency of an insurer's capital and claims-paying ability and include the impact of transactions with affiliated entities. Certain jurisdictions require the disclosure of solvency ratios to the public. Insurers that have lower solvency ratios than the regulators require are considered to have inadequate capital and are subject to varying degrees of regulatory action depending upon the level of capital inadequacy.

Changes in solvency regulation from jurisdiction to jurisdiction may arise based on the regulatory standards developed by the Financial Stability Board ("FSB"), IAIS or authorities in the U.S. or the European Economic Area ("EEA"). FSB and IAIS developments are described below under "—International and Global Regulatory Initiatives."

Japan Capital and Solvency Regulation. Our Japan insurance operations are subject to a consolidated basis capital standard known as the Solvency Margin Ratio framework ("SMR"). This standard prescribes the manner in which an insurance company's capital is calculated and is meant to respond to changes in financial markets, improve risk management practices of insurers and consider risks associated with the insurer's subsidiaries. In 2016 and 2018, the FSA conducted a field test of a potential market based alternative to the SMR framework that closely aligned with components of the IAIS's Risk-based Global Insurance Capital Standard ("ICS"), which is described below under "—Other International and Global Regulatory Initiatives." The FSA may continue to explore potential alternatives or revisions to the existing SMR framework. We cannot predict whether changes to the SMR will be adopted, or if they will result in additional capital requirements and compliance costs.

Korea Accounting Standards, Capital and Solvency Regulation. In 2017, the International Accounting Standards Board ("IASB") released a new International Financial Reporting Standard ("IFRS") for accounting for insurance contracts, which will apply to our operations in Korea and certain other jurisdictions. The new IFRS was initially scheduled to go into effect in 2021; however, in 2018 the IASB deferred the effective date to 2022. Korea's Financial Supervisory Service and Financial Services Commission announced plans to enhance the liability adequacy test in June 2017 as part of its adoption effort. The enhancements require life insurers to set aside additional policy reserves in phases to support the transition to IFRS, which is expected to lead to an increase in the level of reserves insurers must hold. In Japan, changes in IFRS do not currently impact our operations as they are not required to report under IFRS.

Our Korea insurance operation is subject to RBC requirements that are based in part on financial statements prepared in accordance with current accounting requirements. In 2017 and 2018, the Financial Supervisory Service ("FSS") of Korea conducted a field test of a potential market based alternative to the RBC framework that closely aligned with components of the IAIS' ICS. The FSS will continue to explore potential alternatives or revisions to the existing RBC framework through further quantitative impact studies with the intention of implementing changes in parallel with its implementation of the new IFRS standards for accounting for insurance contracts. We cannot predict whether changes to the RBC framework will ultimately be adopted, or if they will result in additional capital requirements and compliance costs.

Dividend Payment Limitations

The insurance regulatory bodies in some of the countries where our international insurance businesses are located regulate the amount of dividends that they can pay to shareholders. See Note 15 to the Consolidated Financial Statements for additional information regarding the ability of our international subsidiaries to pay dividends to Prudential Financial.

Insurance Guaranty Fund Assessments

Certain of our international insurance operations, including those in Japan, may be subject to assessments, generally based on their proportionate share of business written in the relevant jurisdiction, for certain obligations of insolvent insurance companies to policyholders and claimants. As we cannot predict the timing of future assessments, they may materially affect the results of operations of our international insurance operations in particular quarterly or annual periods. Under the Japanese insurance guaranty law, all licensed life insurers in Japan are required to be members of and are assessed, on a pre-funded basis, by the Japan Policyholders Protection Corporation ("PPC"). These assessments generate a collective fund which is used to satisfy certain

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obligations of insolvent insurance companies to policyholders and claimants. The PPC assesses each member in an amount related to its proportionate share of new business written by all member insurers. For the years ended December 31, 2018, 2017 and 2016, we paid approximately $22 million, $21 million and $22 million, respectively, based on fixed currency exchange rates, in assessments pursuant to Japanese insurance guaranty association laws.

U.S. Investment and Retirement Products and Investment Management Operations

Our investment products and services are subject to federal and state securities, fiduciary, including ERISA, and other laws and regulations. The SEC, FINRA, the Commodity Futures Trading Commission ("CFTC"), state securities commissions, state banking and insurance departments and the DOL are the principal U.S. regulators that regulate our investment management operations. In some cases our domestic U.S. investment operations are also subject to non-U.S. securities laws and regulations.

Some of the separate account, mutual fund and other pooled investment products offered by our businesses, in addition to being registered under the Securities Act, are registered as investment companies under the Investment Company Act of 1940, as amended, and the shares of certain of these entities are qualified for sale in some states and the District of Columbia. Separate account investment products are also subject to state insurance regulation as described above. We also have several subsidiaries that are registered as broker-dealers under the Securities Exchange Act of 1934 ("Exchange Act"), as amended, and are subject to federal and state regulation. In addition, we have subsidiaries that are investment advisers registered under the Investment Advisers Act of 1940, as amended. Our third-party advisors and licensed sales professionals within Prudential Advisors and other employees, insofar as they sell products that are securities, are subject to the Exchange Act and to examination requirements and regulation by the SEC, FINRA and state securities commissioners. Regulation and examination requirements also extend to various Prudential entities that employ or control those individuals.

Congress from time to time considers pension reform legislation that could decrease or increase the attractiveness of certain of our retirement products and services to retirement plan sponsors and administrators, or have an unfavorable or favorable effect on our ability to earn revenues from these products and services. Over time, these changes could hinder our sales of defined benefit pension products and services and cause sponsors to discontinue existing plans for which we provide investment management, administrative, or other services, but could increase the attractiveness of certain products we offer in connection with pension plans.

Congress is considering legislation that would improve and enhance the U.S.'s existing employer-provided retirement system. Among other things, certain policy measures, if enacted, would help promote plan coverage by expanding access to and use of Multiple Employer Plans; facilitate access to lifetime income disclosures for plan participants to better understand how their retirement savings translate into monthly lifetime income in retirement; improve upon the current annuity selection safe harbor; and provide lifetime income portability.

Finally, Federal and state banking laws also generally require regulatory approval for a change in control of Prudential Financial, Prudential Bank & Trust, FSB ("PB&T") or Prudential Trust Company. The U.S. federal securities laws could also require reapproval or consent by customers of our investment advisory contracts upon a change of control, including for mutual funds included in annuity products.

U.S. Securities and Commodity Operations

We have subsidiaries that are broker-dealers, investment advisers, commodity pool operators or commodity trading advisers. The SEC, the CFTC, state securities authorities, FINRA, the National Futures Association ("NFA"), the Municipal Securities Rulemaking Board, and similar authorities are the principal regulators of these subsidiaries.

Our broker-dealer and commodities affiliates are members of, and are subject to regulation by, “self-regulatory organizations,” including FINRA and the NFA. Self-regulatory organizations conduct examinations of, and have adopted rules governing, their members. In addition, state securities and certain other regulators have regulatory and oversight authority over our registered broker-dealers. Broker-dealers and their sales forces in the U.S. and in certain other jurisdictions are subject to regulations that cover many aspects of the securities business, including sales methods and trading practices. The regulations cover the suitability of investments for individual customers, use and safekeeping of customers’ funds and securities, capital adequacy, recordkeeping, financial reporting and the conduct of directors, officers and employees. The SEC, CFTC and other governmental agencies and self-regulatory organizations, as well as state securities commissions in the U.S. and non-U.S. regulatory agencies, have the power to conduct administrative proceedings that can result in censure, fine, the issuance of cease-and-desist orders or suspension, termination or limitation of the activities of a broker-dealer, an investment adviser or commodities firm or its employees. Our U.S. registered broker-dealer subsidiaries are subject to federal net capital requirements that may limit the ability of these subsidiaries to pay dividends to Prudential Financial.

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International Investment and Retirement Products and Investment Management Operations

Our non-insurance international operations are supervised primarily by regulatory authorities in the countries in which they operate. We operate investment-related businesses in, among other jurisdictions, Japan, Taiwan, the U.K., Ireland, Hong Kong, Mexico, Germany, Luxembourg, China and Singapore, and participate in investment-related joint ventures in India, Italy and China and a retirement related joint venture in Chile. These businesses may provide products such as investment management products and services, mutual funds, separately managed accounts and retirement products. The regulatory authorities for these businesses typically oversee such issues as: (1) company licensing; (2) the licensing of investment product sales staff; (3) sales practices; (4) solvency and capital adequacy; (5) mutual fund product approvals and related disclosures; and (6) securities, commodities and related laws, among other items. In some cases, our international investment operations are also subject to U.S. securities laws and regulations.

In June 2016, the U.K. approved a non-binding referendum to exit the European Union. The formal process for the U.K. to exit from the European Union remains subject to ongoing negotiation between the U.K. and the European Union on the timing and terms of the exit. The outcome of the negotiations will determine the ultimate impact of the exit on our operations and investments in those jurisdictions and may lead to volatility in currency exchange rates and asset prices, as well as changes in regulation. In the event the exit results in future restrictions on cross-border trade in financial services and products between the U.K. and the European Union, PGIM may incur additional expenses and operational burdens in order to ensure compliance with such restrictions. PGIM has implemented a number of steps to seek to ensure it is prepared, to the extent possible, for various outcomes, including forming new legal entities and applying for licenses and permissions in certain European Union countries, and engaging in client communications.

Derivatives Regulation

Prudential Financial and our subsidiaries use derivatives for various purposes, including hedging interest rate, foreign currency and equity market exposures. Dodd-Frank established a framework for regulation of the over-the-counter derivatives markets. This framework sets out requirements regarding the clearing and reporting of derivatives transactions, as well as collateral posting requirements for uncleared swaps. Affiliated swaps entered into between our subsidiaries are generally exempt from most of these requirements.

We continue to monitor the potential hedging cost impacts of new initial margin requirements that we will be required to comply with in 2020, and increased capital requirements for derivatives transactions that may be imposed on banks that are our counterparties. Additionally, the increased need to post cash collateral in connection with mandatorily cleared swaps may also require the liquidation of higher yielding assets for low yielding cash, resulting in a negative impact on investment income.

Privacy and Cybersecurity Regulation

We are subject to laws, regulations and directives that require financial institutions and other businesses to protect the security and confidentiality of personal information, including health-related and customer information, and to notify their customers and other individuals of their policies and practices relating to the collection and disclosure of health-related and customer information. In addition, we must comply with international privacy laws, regulations, and directives concerning the cross border transfer or use of employee and customer personal information. These laws, regulations and directives also:

- provide additional protections regarding the use and disclosure of certain information such as social security numbers;
- require notice to affected individuals, regulators and others if there is a breach of the security of certain personal information;

- require financial institutions and creditors to implement effective programs to detect, prevent, and mitigate identity theft;
- regulate the process by which financial institutions make telemarketing calls and send e-mail or fax messages to consumers and customers; and
- prescribe the permissible uses of certain personal information, including customer information and consumer report information.

Financial regulators in the U.S. and international jurisdictions in which we operate continue to focus on data privacy and cybersecurity, including in proposed rulemaking, and have communicated heightened expectations and have increased emphasis in this area in their examinations of regulated entities. For example, the European Union’s General Data Protection Regulation (“GDPR”), which became effective in May 2018, confers additional privacy rights on individuals in the European Union and establishes penalties for violations. In addition, in the United States the Federal government has proposed a number of laws similar to the GDPR and California has enacted broad legislation effective in 2020 which is similar in many ways to the GDPR.



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Internationally, a number of countries such as Brazil and Argentina have enacted or are considering enacting GDPR-like regulations.

In October 2017, the NAIC adopted the Insurance Data Security Model Law. The model law requires that insurance companies establish a cybersecurity program and includes specific technical safeguards as well as requirements regarding governance, incident planning, data management, system testing, vendor oversight and regulator notification. New York implemented a similar law in March 2017 and other states have either implemented the Model Law or are anticipated to implement it in the near future.

The Company is monitoring regulatory guidance and rulemaking in this area, and may be subject to increased compliance costs and regulatory requirements. In order to respond to the threat of security breaches and cyber-attacks, we have developed a program overseen by the Chief Information Security Officer and the Information Security Office that is designed to protect and preserve the confidentiality, integrity, and continued availability of all information owned by, or in the care of the Company. As part of this program, we also maintain an incident response plan. The program provides for the coordination of various corporate functions and governance groups, and serves as a framework for the execution of responsibilities across businesses and operational roles. The program establishes security standards for our technological resources, and includes training for employees, contractors and third parties. As part of the program, we conduct periodic exercises and a response readiness assessment with outside advisors to gain a third-party independent assessment of our technical program and our internal response preparedness. We regularly engage with the outside security community and monitor cyber threat information.

Anti-Money Laundering and Anti-Bribery Laws

Our businesses are subject to various anti-money laundering and financial transparency laws and regulations that seek to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering. In addition, under current U.S. law and regulations we may be prohibited from dealing with certain individuals or entities in certain circumstances and we may be required to monitor customer activities, which may affect our ability to attract and retain customers. We are also subject to various laws and regulations relating to corrupt and illegal payments to government officials and others, including the U.S. Foreign Corrupt Practices Act and the U.K.'s Anti-Bribery Law. The obligation of financial institutions, including the Company, to identify their clients, to monitor for and report suspicious transactions, to monitor dealings with government officials, to respond to requests for information by regulatory authorities and law enforcement agencies, and to share information with other financial institutions, has required the implementation and maintenance of internal practices, procedures and controls.

Environmental Laws and Regulations

Federal, state and local environmental laws and regulations apply to our ownership and operation of real property. Inherent in owning and operating real property are the risks of hidden environmental liabilities and the costs of any required clean-up. Although unexpected environmental liabilities can always arise, we seek to minimize this risk by undertaking environmental assessments, among other measures prior to taking title to real estate.

Unclaimed Property Laws

We are subject to the laws and regulations of states and other jurisdictions concerning the identification, reporting and escheatment of unclaimed or abandoned funds, and we are subject to audit and examination for compliance with these requirements. For additional discussion of these matters, see Note 22 to the Consolidated Financial Statements.

Taxation

U.S. Taxation

The Company and certain domestic subsidiaries file a consolidated federal income tax return that includes both life insurance companies and non-life insurance companies. Certain other domestic subsidiaries file separate tax returns. The principal differences between the Company's actual income tax expense and the applicable statutory federal income tax rate are generally deductions for non-taxable investment income, including the Dividends Received Deduction ("DRD"), foreign taxes applied at a different tax rate than the U.S. rate and certain tax credits. For tax years prior to 2018, the applicable statutory federal tax rate was 35%. For tax years starting in 2018, the applicable statutory federal income tax rate is 21%. In addition, as discussed further below, the tax attributes of our products may impact both the Company's and our customers' tax positions. See "Income Taxes" in Note 2 to the Consolidated Financial Statements and Note 15 to the Consolidated Financial Statements for a description of the Company's tax position. As discussed further below, new tax legislation and other potential changes to the tax law may impact the Company's tax position and the attractiveness of our products.

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The Tax Act of 2017 was enacted into law on December 22, 2017 and was generally effective starting in 2018. The Tax Act of 2017 changes the taxation of businesses and individuals by lowering tax rates and broadening the tax base through the acceleration of taxable income and the deferral or elimination of certain deductions, as well as changing the system of taxation of earnings of foreign subsidiaries. The most significant changes for the Company are: (1) the reduction of the corporate tax rate from 35% to 21%; (2) revised methodologies for determining deductions for tax reserves and the DRD; (3) an increased capitalization and amortization period for acquisition costs related to certain products; and (4) the change from a worldwide deferred taxation system to a modified territorial system of taxation on applicable earnings of foreign subsidiaries, which includes (a) a new tax on earnings of foreign subsidiaries (the Global Intangible Low-Taxed Income ("GILTI") provision ) and (b) a new alternative tax with respect to payments to non-U.S. affiliates that are at least 25% owned (the Base Erosion Anti-Abuse Tax ("BEAT")). The lower corporate tax rate reduced the Company's domestic statutory capital and risk-based capital. For additional details, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Capital—Insurance Regulatory Capital."

The GILTI provision applies a minimum U.S. tax to earnings of foreign subsidiaries in excess of a 10% deemed return on tangible assets of consolidated foreign subsidiaries by imposing the U.S. tax rate to 50% of earnings of such foreign affiliates and provides for a partial foreign tax credit for foreign income taxes. The amount of tax in any period on GILTI can depend on annual differences between U.S. taxable income recognition rules and taxable income recognition rules in the country of operations and the overall taxable income of U.S. operations, as well as U.S. expense allocation rules which limit the amount of foreign tax credits that can be applied to reduce the U.S. tax on the GILTI. Under certain circumstance the taxable income of U.S. operations may cause more than 50% of earnings of foreign affiliates to be subject to the GILTI provision. In years that the U.S. consolidated PFI group incurs a net operating loss or has a loss from domestic businesses, the GILTI provision would operate to cause a loss of U.S. tax benefits for some or all of those losses, effectively increasing the tax on foreign earnings.

The BEAT provision could, under certain conditions, increase our tax expense. The BEAT is an alternative tax implicated if tax deductible payments from U.S. companies to foreign affiliates that are at least 25% owned exceed 3% of total U.S. tax deductions. If implicated, the BEAT taxes modified taxable income at a rate of 5% in 2018, increasing to 10% in 2019 and 12.5% in 2026 and is due if the calculated BEAT tax amount that is determined without the benefit of foreign and certain other tax credits is greater than the regular corporate tax in any given year. In general, modified taxable income is calculated by adding back to a taxpayer's regular taxable income the amount of certain "base erosion tax benefits" with respect to payments to foreign affiliates, as well as the "base erosion percentage" of any net operating loss deductions. It is possible that benefit and claim payments made by our U.S. insurance business to our foreign affiliates on reinsurance assumed by the U.S. affiliates could be considered base erosion payments and, in the future, cause the U.S. consolidated PFI group to be subject to the BEAT.

During 2018 the Treasury Department and the Internal Revenue Service ("IRS") promulgated Proposed Regulations on a number of provisions within or impacted by the Tax Act of 2017 including GILTI, foreign tax credits, net interest deductibility and the BEAT. The Treasury and IRS have requested comments on the Proposed Regulations. Our analysis of these Proposed Regulations is on-going and further guidance may be needed from the Treasury Department and the IRS to fully understand and implement several provisions. Other life insurance and financial services companies may benefit more or less from these tax law changes, which could impact the Company's overall competitive position. Notwithstanding the enactment of the Tax Act of 2017, the President, Congress, as well as state and local governments, may continue to consider from time to time legislation that could increase the amount of corporate taxes we pay, thereby reducing earnings.

U.S. federal tax law generally permits tax deferral on the inside build-up of investment value of certain retirement savings, annuities and life insurance products until there is a contract distribution and, in general, excludes from taxation the death benefit paid under a life insurance contract. The Tax Act of 2017 did not change these rules, though

it is possible that some individuals with overall lower effective tax rates could be less attracted to the tax deferral aspect of the Company's products. The general reduction in individual tax rates and elimination of certain individual deductions may also impact the Company depending on whether current and potential customers have more or less after-tax income to save for retirement and manage their mortality and longevity risk through the purchase of the Company's products. Congress from time to time may enact other changes to the tax law that could make our products less attractive to consumers, including legislation that would modify the tax favored treatment of retirement savings, life insurance and annuities products.

The products we sell have different tax characteristics and, in some cases, generate tax deductions and credits for the Company. Changes in either the U.S. or foreign tax laws may negatively impact the deductions and credits available to the Company, including the ability of the Company to claim foreign tax credits with respect to taxes withheld on our investments supporting separate account products. These changes would increase the Company's actual tax expense and reduce its consolidated net income.

The profitability of certain products is significantly dependent on these characteristics and our ability to continue to generate taxable income, which is taken into consideration when pricing products and is a component of our capital management strategies.

Accordingly, changes in tax law, our ability to generate taxable income, or other factors impacting the availability or value of the tax characteristics generated by our products, could impact product pricing and returns or require us to reduce our sales of these products or implement other actions that could be disruptive to our businesses.

International Taxation

Our international businesses are subject to the tax laws and regulations of the countries in which they are organized and in which they operate. Foreign governments from time to time consider legislation that could impact the amount of taxes that we pay or impact the sales of our products. For example, the Organization of Economic Cooperation and Development continues to study model global base erosion tax options that may be considered and adopted by foreign governments. Such changes could negatively impact sales of our products or reduce our profits.

On December 19, 2017, South Korea enacted a 2018 tax reform bill that adds a new 25% corporate income tax bracket for taxable income in excess of 300 billion for tax years beginning on or after January 1, 2018. Taxable income in excess of 20 billion but less than 300 billion continues to be subject to a 22% corporate income tax. In addition, corporations continue to be subject to a local income surtax of 10% of the computed corporate income tax (e.g., 2.5% for the tax base in excess of 300 billion, 2.2% for the tax base between 20 billion and 300 billion). After taking into account this 10% local income tax surcharge on corporate tax, the 2018 tax reform bill increased the top corporate income tax rate in South Korea from 24.2% to 27.5%.

Prior to 2017, the Japan national corporate tax rate was reduced from 23.9% for tax years beginning on or after April 1, 2015, to 23.4% for tax years beginning on or after April 1, 2016, and to 23.2% for tax years beginning on or after April 1, 2018. In addition, there are local income taxes that are applied to our income earned in Japan. The Japanese consumption tax rate is currently 8% and is scheduled to increase to 10% on October 1, 2019. Insurance commissions paid to our Life Planners and Life Consultants are subject to consumption tax for individuals exceeding certain earnings thresholds; however, the tax is not charged on employee compensation (other than commissions) or insurance premiums.

International and Global Regulatory Initiatives

In addition to the adoption of Dodd-Frank in the United States, lawmakers around the world are actively exploring steps to avoid future financial crises. In many respects, this work is being led by the FSB, which consists of representatives of national financial authorities of the G20 nations. The G20, the FSB and related bodies have developed proposals to address such issues as financial group supervision, capital and solvency standards, systemic economic risk, corporate governance including executive compensation, and a host of related issues.

In July 2013, we along with eight other global insurers, were designated by the FSB as a global systemically important insurer (“G-SII”) through a quantitative methodology developed and implemented by the IAIS. Similar assessments were performed and subsequent G-SII designation lists were issued annually through November 2016. We remained designated as a G-SII throughout this period. In November 2017, the FSB announced that the list of G-SIIs identified in 2016 would stand until November 2018, at which point it would assess the progress made by the IAIS’ on the development of an Activities-Based Approach (“ABA”) to assessing and managing potential systemic risk in the insurance sector. Over the course of 2018, the IAIS’ work to develop an ABA evolved into the development of a Holistic Framework for Systemic Risk in the Insurance Sector (“Holistic Framework”). Key elements of the Holistic Framework include enhancements to IAIS policy measures pertaining to macroprudential surveillance, enterprise risk management, liquidity management, crisis management and recovery planning as well as the continuation of annual data collection and monitoring by the IAIS. The IAIS will finalize the Holistic Framework in 2019 for implementation in 2020. In November 2018, the FSB announced that it would not engage in an identification of G-SIIs based on progress made on the development of the Holistic Framework and that it will assess an IAIS recommendation to

suspend G-SII identification from 2020 in November 2019. The FSB further announced that it will review the need to either discontinue or re-establish the annual identification of G-SIIs in November 2022.

In addition to its work on assessing and managing potential systemic risk, the IAIS is developing the Common Framework for the Supervision of Internationally Active Insurance Groups (“ComFrame”). Through ComFrame, the IAIS seeks to promote effective and globally consistent supervision of the insurance industry through uniform standards for insurer corporate governance, enterprise risk management and other control functions, group-wide supervision and group capital adequacy. The non-capital related components of ComFrame are being developed iteratively through a series of public consultations and are scheduled to be adopted by the IAIS in November 2019. The ICS, which is the capital adequacy component of ComFrame, is also being developed iteratively through both a series of public consultations and voluntary field tests. In November 2017, the IAIS announced an agreement among its members on the development and implementation of the ICS. Terms of the agreement include: adoption of the ICS by the IAIS in November 2019; a five-year monitoring phase beginning in 2020 during which IAIGs are to report ICS results to their group supervisory authorities; and implementation of the ICS at the jurisdictional level in 2025.

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As a standard setting body, the IAIS does not have direct authority to require insurance companies to comply with the policy measures it develops, including the ICS and proposed policy measures within the Holistic Framework. However, if the policy measures were adopted by either our group supervisor or supervisors of our international operations or companies, we could become subject to these standards. Adoption of IAIS policy measures could impact the manner in which we deploy our capital, structure and manage our businesses, and otherwise operate both within the U.S. and abroad. The possibility of inconsistent and conflicting regulation of Prudential at the group level and the subsidiary level also exists as law makers and regulators in multiple jurisdictions simultaneously pursue these initiatives.

### Employees

As of December 31, 2018, we had 50,492 employees and sales associates, including 29,506 located outside of the United States. We believe our relations with our employees and sales associates are satisfactory.

### Available Information

Prudential Financial files periodic and current reports, proxy statements and other information with the SEC. Such reports, proxy statements and other information may be obtained through the SEC's website (www.sec.gov).

You may also access our press releases, financial information and reports filed with the SEC (for example, our Annual Report on Form 10-K, our Quarterly Reports on Form 10-Q, our Current Reports on Form 8-K and any amendments to those Forms) online at www.investor.prudential.com. Copies of any documents on our website are available without charge, and reports filed with or furnished to the SEC will be available as soon as reasonably practicable after they are filed with or furnished to the SEC. The information found on our website is not part of this or any other report filed with or furnished to the SEC.

## ITEM 1A. RISK FACTORS

You should carefully consider the following risks. 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 Annual Report on Form 10-K. Many of these risks are interrelated and could occur under similar business and economic conditions, and the occurrence of certain of them may in turn cause the emergence or exacerbate the effect of others. Such a combination could materially increase the severity of the impact of these risks on our businesses, results of operations, financial condition and liquidity.

### Overview

The Company's risk management framework documents the definition, potential manifestation, and management of its risks. The Company has categorized its risks into tactical and strategic risks. Tactical risks may cause damage to the Company, and the Company seeks to manage and mitigate them through models, metrics and the overall risk framework. The Company's tactical risks include investment, insurance, market, liquidity, and operational risk. Strategic risks can cause the Company's fundamental business model to change, either through a shift in the businesses in which it is engaged or a change in execution. The Company's strategic risks include regulatory, technological changes and other external factors. These risks, as well as the sub-risks that may impact the Company, are discussed below. The Company's risk management framework is described under "Management's Discussion and Analysis of Financial Condition and Results of Operations—Risk Management."

Investment Risk

Our investment portfolios are subject to the risk of loss due to default or deterioration in credit quality or value.

We are exposed to investment risk through our investments, which primarily consist of public and private fixed maturity securities, commercial mortgage and other loans, equity securities and alternative assets including private equity, hedge funds and real estate. For a discussion of our general account investments, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—General Account Investments." We are also exposed to investment risk through a potential counterparty default.

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Investment risk may result from (1) economic conditions, (2) adverse capital market conditions, including disruptions in individual market sectors or a lack of buyers in the marketplace, (3) volatility, (4) credit spread changes, (5) benchmark interest rate changes, (6) changes in foreign currency exchange rates and (7) declines in value of underlying collateral. These factors may impact the credit quality, liquidity and value of our investments and derivatives, potentially resulting in higher capital charges and unrealized or realized losses. Also, certain investments we hold, regardless of market conditions, are relatively illiquid and our ability to promptly sell these assets for their full value may be limited. Additionally, our valuation of investments may include methodologies, inputs and assumptions which are subject to change and different interpretation and could result in changes to investment valuations that may materially impact our results of operations or financial condition. For information about the valuation of our investments, see Note 6 to the Consolidated Financial Statements.

Our investment portfolio is subject to credit risk, which is the risk that an obligor (or guarantor) is unable or unwilling to meet its contractual payment obligations on its fixed maturity security, loan or other obligations. Credit risk may manifest in an idiosyncratic manner (i.e., specific to an individual borrower or industry) or through market-wide credit cycles. Financial deterioration of the obligor increases the risk of default and may increase the capital charges required under such regimes as the NAIC RBC, the FSA SMR or other constructs to hold the investment and in turn, potentially limit our overall capital flexibility. Credit defaults (as well as credit impairments, realized losses on credit-related sales, and increases in credit related reserves) may result in losses which adversely impact earnings, capital and our ability to appropriately match our liabilities and meet future obligations.

Our Company is subject to counterparty risk, which is the risk that the counterparty to a transaction could default or deteriorate in creditworthiness before or at the final settlement of a transaction. In the normal course of business, we enter into financial contracts to manage risks (such as derivatives to manage market risk and reinsurance treaties to manage insurance risk), improve the return on investments (such as securities lending and repurchase transactions) and provide sources of liquidity or financing (such as credit agreements, securities lending agreements and repurchase agreements). These transactions expose the Company to counterparty risk. Counterparties include commercial banks, investment banks, broker-dealers and insurance and reinsurance companies. In the event of a counterparty deterioration or default, the magnitude of the losses will depend on then current market conditions and the length of time required to enter into a replacement transaction with a new counterparty. Losses are likely to be higher under stressed conditions.

Our investment portfolio is subject to equity risk, which is the risk of loss due to deterioration in market value of public equity or alternative assets. We include public equity and alternative assets (including private equity, hedge funds and real estate) in our portfolio constructions, as these asset classes can provide returns over longer periods of time, aligning with the long-term nature of certain of our liabilities. Public equity and alternative assets have varying degrees of price transparency. Equities traded on stock exchanges (public equities) have significant price transparency, as transactions are often required to be disclosed publicly. Assets for which price transparency is more opaque include private equity (joint ventures/limited partnerships) and direct real estate. As these investments typically do not trade on public markets and indications of realizable market value may not be readily available, valuations can be infrequent and/or more volatile. A sustained decline in public equity and alternative markets may reduce the returns earned by our investment portfolio through lower than expected dividend income, property operating income, and capital gains, thereby adversely impacting earnings, capital, and product pricing assumptions. These assets may also produce volatility in earnings as a result of uneven distributions on the underlying investments.

Insurance Risk

We have significant liabilities for policyholders’ benefits which are subject to insurance risk. Insurance risk is the risk that actual experience deviates adversely from our best estimate insurance assumptions, including mortality, morbidity, and policyholder behavior assumptions.

We provide a variety of insurance products, on both an individual and group basis, that are designed to help customers protect against a variety of financial uncertainties. Our insurance products protect customers against their potential risk of loss by transferring those risks to the Company, where those risks can be managed more efficiently through pooling and diversification over a larger number of independent exposures. During this transfer process, we assume the risk that actual losses experienced in our insurance products deviates significantly from what we expect. More specifically, insurance risk is concerned with the deviations that impact our future liabilities. Our profitability may decline if mortality experience, morbidity experience or policyholder behavior experience differ significantly from our expectations when we price our products. In addition, if we experience higher than expected claims our liquidity position may be adversely impacted, and we may incur losses on investments if we are required to sell assets in order to pay claims. If it is necessary to sell assets at a loss, our results of operations and financial condition could be adversely impacted. For a discussion of the impact of changes in insurance assumptions on our financial condition, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Accounting Policies and Pronouncements—Application of Critical Accounting Estimates—Insurance Liabilities."

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Certain of our insurance products are subject to mortality risk, which is the risk that actual deaths experienced deviate adversely from our expectations. Mortality risk is a biometric risk that can manifest in the following ways:

- Mortality calamity is the risk that mortality rates in a single year deviate adversely from what is expected as the result of pandemics, natural or man-made disasters, military actions or terrorism. A mortality calamity event will reduce our earnings and capital and we may be forced to liquidate assets before maturity in order to pay the excess claims. Mortality calamity risk is more pronounced in respect of specific geographic areas (including major metropolitan centers, where we have concentrations of customers, including under group and individual life insurance), concentrations of employees or significant operations, and in respect of countries and regions in which we operate that are subject to a greater potential threat of military action or conflict. Ultimate losses would depend on several factors, including the rates of mortality and morbidity among various segments of the insured population, the collectability of reinsurance, the possible macroeconomic effects on our investment portfolio, the effect on lapses and surrenders of existing policies, as well as sales of new policies and other variables.
- Mortality trend is the risk that mortality improvements in the future deviate adversely from what is expected. Mortality trend is a long-term risk in that can emerge gradually over time. Longevity products, such as annuities, pension risk transfer and long-term care, experience adverse impacts due to higher-than-expected mortality improvement. Mortality products, such as life insurance, experience adverse impacts due to lower-than-expected improvement. If this risk were to emerge, the Company would update assumptions used to calculate reserves for in-force business, which may result in additional assets needed to meet the higher expected annuity claims or earlier expected life claims. An increase in reserves due to revised assumptions has an immediate impact on our results of operations and financial condition; however, economically the impact is generally long term as the excess outflow is paid over time.
- Mortality base is the risk that actual base mortality deviates adversely from what is expected in pricing and valuing our products. Base mortality risk can arise from a lack of credible data on which to base the assumptions.

Certain of our insurance products are subject to morbidity risk, which is the risk that either incidence or continuation experience deviates adversely from what is expected. Morbidity risk is a biometric risk that can manifest in the following ways:

- Morbidity incidence is the risk that the rate at which policyholders become unhealthy (and qualify for benefits under insurance policies) deviates adversely from what is expected. We are primarily exposed to morbidity incidence risk through short-term disability products, long-term disability products, long-term care products, and the accident and health products we sell in Japan.
- Morbidity continuation is the risk that the length of time for which policyholders remain unhealthy deviates adversely from what is expected. This risk is primarily in our disability and long-term care products.

In each case, an increase in claims, or an increase in reserves due to revised morbidity assumptions can have an immediate impact on our results of operations and financial condition; however, economically the impact of morbidity risk for products that pay out for ongoing illness or disability generally emerges over the longer term as the morbidity claims are paid.

Certain of our insurance products are subject to policyholder behavior risk, which is the risk that actual policyholder behavior deviates adversely from what is expected. Policyholder behavior risk includes the following components:

- Lapse calamity is the risk that lapse rates over the short-term deviate adversely from what is expected, for example, surrenders of certain insurance products may increase following a downgrade of our financial strength ratings or adverse publicity. Only certain products are exposed to this risk. Products that offer a cash surrender value that resides in the general account, such as general account stable value products, could pose a potential short-term lapse calamity

risk. Surrender of these products can impact liquidity, and it may be necessary in certain market conditions to sell assets to meet surrender demands. Lapse calamity can also impact our earnings through its impact on estimated future profits.

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- Policyholder behavior efficiency is the risk that the behavior of our customers or policyholders deviates adversely from what is expected. Policyholder behavior efficiency risk arises through product features which provide some degree of choice or flexibility for the policyholder, which can impact the amount and/or timing of claims. Such choices include surrender, lapse, partial withdrawal, policy loan, utilization, and premium payment rates for contracts with flexible premiums. While some behavior is driven by macro factors such as market movements, policyholder behavior at a fundamental level is driven primarily by policyholders' individual needs, which may differ significantly from product to product depending on many factors including the features offered, the approach taken to market each product, and competitor pricing. For example, persistency (the probability that a policy or contract will remain in force) within our annuities business may be significantly impacted by the value of guaranteed minimum benefits contained in many of our variable annuity products being higher than current account values in light of poor market performance as well as other factors. Many of our products also provide our customers with wide flexibility with respect to the amount and timing of premium deposits and the amount and timing of withdrawals from the policy's value. Results may vary based on differences between actual and expected premium deposits and withdrawals for these products, especially if these product features are relatively new to the marketplace. The pricing of certain of our variable annuity products that contain certain living benefit guarantees is also based on assumptions about utilization rates, or the percentage of contracts that will utilize the benefit during the contract duration, including the timing of the first withdrawal. Results may vary based on differences between actual and expected benefit utilization. We may also be impacted by customers seeking to sell their benefits. In particular, the development of a secondary market for life insurance, including life settlements or "viaticals" and investor owned life insurance, and third-party investor strategies in the annuities business, could adversely affect the profitability of existing business and our pricing assumptions for new business. Policyholder behavior efficiency is generally a long-term risk that emerges over time. An increase in reserves due to revised assumptions has an immediate impact on our results of operations and financial condition; however, from an economic or cash flow perspective, the impact is generally long term as the excess outflow is paid over time.

Our ability to reprice products is limited and may not compensate for deviations from our expected insurance assumptions.  Although some of our products permit us to increase premiums or adjust other charges and credits during the life of the policy or contract, the adjustments permitted under the terms of the policies or contracts may not be sufficient to maintain profitability or may cause the policies or contracts to lapse. For example, for our long-term care insurance products, our assumptions for reserves for future policy benefits have factored in an 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. Many of our products do not permit us to increase premiums or adjust other charges and credits or limit those adjustments during the life of the policy or contract. Even if permitted under the policy or contract, we may not be able or willing to raise premiums or adjust other charges sufficiently, or at all. Accordingly, significant deviations in actual experience from our pricing assumptions could have an adverse effect on the profitability of our products.

Market Risk

The profitability of many of our insurance and annuity products, as well as the fees we earn in our investment management business, are subject to market risk. Market risk is the risk of loss from changes in interest rates, equity prices and foreign currency exchange rates.

The profitability of many of our insurance and annuity products depends in part on the value of the separate accounts supporting these products, which can fluctuate substantially depending on market conditions. Market conditions resulting in reductions in the value of assets we manage has an adverse effect on the revenues and profitability of our investment management business, which depends on fees related primarily to the value of assets under management, and could decrease the value of our strategic investments.

Derivative instruments we use to hedge and manage foreign exchange, interest rate and equity market risks associated with our products and businesses, and other risks might not perform as intended or expected, resulting in higher than expected realized losses and stresses on liquidity. Market conditions can limit availability of hedging instruments, require us to post additional collateral, and further increase the cost of executing product related hedges and such costs may not be recovered in the pricing of the underlying products being hedged.

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Market risk may limit opportunities for investment of available funds at appropriate returns, including due to the current low interest rate environment, or other factors, with possible negative impacts on our overall results. Limited opportunities for attractive investments may lead to holding cash for long periods of time and increased use of derivatives for duration management and other portfolio management purposes. The increased use of derivatives may increase the volatility of our U.S. GAAP results and our statutory capital.

Our investments, results of operations and financial condition may also be adversely affected by developments in the global economy, in the U.S. economy (including as a result of actions by the Federal Reserve with respect to monetary policy, and adverse political developments), and in the Japanese economy (including due to the effects of inflation or deflation, interest rate volatility, changes in the Japan sovereign credit rating, and material changes in the value of the Japanese yen relative to the U.S. dollar). Global, U.S. or Japanese economic activity and financial markets may in turn be negatively affected by adverse developments or conditions in specific geographical regions.

For a discussion of the impact of changes in market conditions on our financial condition see "Quantitative and Qualitative Disclosures About Market Risk."

Our insurance and annuity products and certain of our investment products, and our investment returns, are subject to interest rate risk, which is the risk of loss arising from asset/liability duration mismatches within our general account investments as well as invested assets of other entities and operations. The risk of mismatch in asset/liability duration is mainly driven by the specific dynamics of product liabilities. Some product liabilities are expected to have only modest risk related to interest rates because cash flows can be matched by available assets in the investable space. The interest rate risk emerges primarily from their tail cash flows (30 years or more), which cannot be matched by assets for sale in the marketplace, exposing the Company to future reinvestment risk. Market-sensitive cash flows exist with other product liabilities including products whose cash flows can be linked to market performance through secondary guarantees, minimum crediting rates, and/or changes in insurance assumptions.

Our exposure to interest rates can manifest over years as in the case of earnings compression or in the short term by creating volatility in both earnings and capital. For example, some of our products expose us to the risk that changes in interest rates will reduce the spread between the amounts that we are required to pay under contracts and the rate of return we are able to earn on our general account investments supporting these contracts. When interest rates decline or remain low, as they have in recent years, we must invest in lower-yielding instruments, potentially reducing net investment income and constraining our ability to offer certain products. This risk is increased as more policyholders may retain their policies in a low rate environment. Since many of our policies and contracts have guaranteed minimum crediting rates or limit the resetting of crediting rates, the spreads could decrease or go negative.

Alternatively, when interest rates rise, we may not be able to replace the assets in our general account with the higher-yielding assets as quickly as needed to fund the higher crediting rates necessary to keep these products and contracts competitive. It is possible that fewer policyholders may retain their policies and annuity contracts as they pursue higher crediting rates, which could expose the Company to losses and liquidity stress. In addition, rising interest rates could cause a decline in the market value of fixed income assets the Company manages which in turn could result in lower asset management fees earned.

Our mitigation efforts with respect to interest rate risk are primarily focused on maintaining an investment portfolio with diversified maturities that has a key rate duration profile that is approximately equal to the key rate duration profile of our liability and surplus benchmarks; however, these benchmarks are based on estimates of the liability cash flow profiles which are complex and could turn out to be inaccurate, especially when markets are volatile. In addition, there are practical and capital market limitations on our ability to accomplish this matching. Due to these and other factors we may need to liquidate investments prior to maturity at a loss in order to satisfy liabilities or be forced to reinvest funds in a lower rate environment.

Our significant business operations outside the U.S. subject us to foreign exchange risk, which is the risk of loss arising from assets that are invested in a different currency than the related liability, as well as the unhedged portion of the Company's earnings from, and capital supporting, operations in a foreign currency. As a U.S.-based company with significant business operations outside of the U.S., particularly in Japan, we are exposed to foreign currency exchange rate risk related to these operations, as well as in our investment portfolio. Fluctuations in foreign currency exchange rates could adversely affect our profitability, financial condition and cash flows, as well as increase the volatility of our results of operations under U.S. GAAP. In the short-term, solvency margins in our Japan businesses can also be impacted by fluctuations in exchange rates.

For our International Insurance operations, our Retirement segment's earnings on non-U.S. dollar-denominated longevity reinsurance contracts and PGIM's investment activities based in currencies other than the U.S. dollar, changes in foreign currency exchange rates create risk that we may experience volatility in the U.S. dollar-equivalent earnings and equity of these operations. We seek to manage this risk through various hedging strategies, including the use of foreign currency hedges and through holding U.S. dollar-denominated securities in the investment portfolios of certain of these operations. Additionally, our Japanese insurance operations offer a variety of non-Japanese yen denominated products. We seek to mitigate this risk by holding investments in corresponding currencies. For certain of our international insurance operations outside of Japan, we elect to not hedge the risk of changes in our subsidiary equity investments due to foreign exchange rate movements.

For our domestic investment portfolios supporting our U.S. insurance operations and other proprietary investment portfolios, our foreign currency exchange rate risk arises primarily from investments that are denominated in foreign currencies. We manage this risk by hedging substantially all domestic foreign currency-denominated fixed-income investments into U.S. dollars. We generally do not hedge all of the foreign currency risk of our investments in equity securities of unaffiliated foreign entities. The value and liquidity of our foreign currency investments could be adversely affected by local market, economic and financial conditions. For example, our investments denominated in euro could be adversely affected by unfavorable economic conditions in Europe, including due to potential changes in the euro or to the structure or membership of the European Union, and in 2016 we experienced volatility in U.K. and other European Union related investments as a result of the U.K.'s referendum to exit the European Union.

There can be no assurance that our hedging and other strategies will effectively mitigate foreign exchange risk. For a discussion of our hedging program and the impact of foreign currency exchange rates on our business, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Impact of Foreign Currency Exchange Rates."

Guarantees within certain of our products, in particular our variable annuities and to a lesser extent certain individual life and international insurance products, are market sensitive and may decrease our earnings or increase the volatility of our results of operations or financial position under U.S. GAAP. Certain of our products, particularly our variable annuity products and to a lesser extent certain individual life and international insurance products, include guarantees of minimum surrender values or income streams for stated periods or for life, which may be in excess of account values. Downturns in equity markets, increased equity volatility, increased credit spreads, or (as discussed above) reduced interest rates could result in an increase in the valuation of liabilities associated with such guarantees, resulting in increases in reserves and reductions in net income. We use a variety of hedging and risk management strategies, including product features, to mitigate these risks in part and we may periodically change our strategies over time. These strategies may, however, not be fully effective. In addition, we may be unable or may choose not to fully hedge these risks. Hedging instruments may not effectively offset the costs of guarantees or may otherwise be insufficient in relation to our obligations. Hedging instruments also may not change in value correspondingly with associated liabilities due to equity market or interest rate conditions, non-performance risk or other reasons. We may choose to hedge these risks on a basis that does not correspond to their anticipated or actual impact upon our results of operations or financial position under U.S. GAAP. Changes from period to period in the valuation of these policy benefits, and in the amount of our obligations effectively hedged, will result in volatility in our results of operations and financial position under U.S. GAAP and the statutory capital levels of our insurance subsidiaries. Estimates and assumptions we make in connection with hedging activities may fail to reflect or correspond to our actual long-term exposure from our guarantees. Further, the risk of increases in the costs of our guarantees not covered by our hedging and other capital and risk management strategies may become more significant due to changes in policyholder behavior driven by market conditions or other factors. The above factors, individually or collectively, may have a material adverse effect on our results of operations, financial condition or liquidity.

Our valuation of the liabilities for the minimum benefits contained in many of our variable annuity products requires us to consider the market perception of our risk of non-performance, and a decrease in our own credit spreads resulting from ratings upgrades or other events or market conditions could cause the recorded value of these liabilities to increase, which in turn could adversely affect our results of operations and financial position.

Liquidity Risk

As a financial services company, we are exposed to liquidity risk, which is the risk that the Company is unable to meet near-term obligations as they come due.

Liquidity risk is a manifestation of events that are driven by other risk types (market, insurance, investment, operational). A liquidity shortfall may arise in the event of insufficient funding sources or an immediate and significant need for cash or collateral. In addition, it is possible that expected liquidity sources, such as our credit facilities, may be unavailable or inadequate to satisfy the liquidity demands described below.

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The Company has four primary sources of liquidity exposure and associated drivers that trigger material liquidity demand. Those sources are:

- Derivative collateral market exposure: Abrupt changes to interest rate, equity, and/or currency markets may increase collateral requirements to counterparties and create liquidity risk for the Company.
- Asset liability mismatch: There are liquidity risks associated with liabilities coming due prior to the matching asset cash flows. Structural maturities mismatch can occur in activities such as securities lending, where the liabilities are effectively overnight open transactions used to fund longer term assets.
- Wholesale funding. The Company depends upon the financial markets for funding (such as through the issuance of commercial paper, securities lending and repurchase arrangements and other forms of borrowings in the capital markets). These sources might not be available during times of stress, or may only be available on unfavorable terms, which can result in a decrease in our profitability and a significant reduction in our financial flexibility.
- Insurance cash flows. The Company faces potential liquidity risks from unexpected cash demands due to severe mortality calamity, customer withdrawals or lapse events. If such events were to occur, the Company may face unexpectedly high levels of claim payments to policyholders.

For a discussion of the Company's liquidity and sources and uses of liquidity, including information about legal and regulatory limits on the ability of our subsidiaries to pay dividends, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Liquidity."

Operational Risk

Our operations are exposed to the risk of loss resulting from inadequate or failed processes or systems, human error or misconduct, and as a result of external events.

An operational risk failure may result in one or more actual or potential impacts to the Company.

Operational Risk Types

- Processes - Processing failure; failure to safeguard or retain documents/records; errors in valuation/pricing models and processes; project management or execution failures; improper sales practices.
- Systems - Failures during the development and implementation of new systems; systems failures.
- People - Internal fraud, breaches of employment law, unauthorized activities; loss or lack of key personnel, inadequate training; inadequate supervision.
- External Events - External crime; outsourcing risk; vendor risk; natural and other disasters; changes in laws/regulations.
- Legal - Legal and regulatory compliance failures.

Potential Impacts

- Financial losses - The Company experiences a financial loss. This loss may originate from various causes including, but not limited to, transaction processing errors and fraud.
- Customer impacts - The Company may not be able to service customers. This may result if the Company is unable to continue operations during a business continuation event or if systems are compromised due to malware or virus.
- Regulatory fines or sanctions - When the Company fails to comply with applicable laws or regulations, regulatory fines or sanctions may be imposed. In addition, possible restrictions on business activities may result.
- Legal actions - Failure to comply with laws and regulations also exposes the Company to litigation risk. This may also result in financial losses.

Liabilities we may incur as a result of operational failures are described further under "Contingent Liabilities" in Note 22 to the Consolidated Financial Statements. In addition, certain pending regulatory and litigation matters affecting us, and certain risks to our businesses presented by such matters, are discussed in Note 22 to the Consolidated Financial Statements. We may become subject to additional regulatory and legal actions in the future.

Key Enterprise Operational Risks - Key enterprise operational risks include the following:

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We are subject to business continuation risk, which is the risk that our systems and data may be disrupted. We depend heavily on our telecommunication, information technology and other operational systems and on the integrity and timeliness of data we use to run our businesses and service our customers. These systems may fail to operate properly or become disabled as a result of events or circumstances wholly or partly beyond our control. Further, we face the risk of operational and technology failures by others, including clearing agents, exchanges and other financial intermediaries and of vendors and parties to which we outsource the provision of services or business operations. We may experience a business continuation event as a result of:

- Severe pandemic, either naturally occurring or intentionally manipulated pathogens.
- Geo-political risks, including armed conflict and civil unrest.
- Terrorist events.
- A significant natural or accidental disaster.

We are subject to the risk that we may not adequately maintain information security. There continues to be significant and organized cyber-attack activity against western organizations, including but not limited to the financial services sector and no organization is fully immune to cyber-attacks. Risks related to cyber-attack arise in the following areas:

- Protecting both “structured” and “unstructured” sensitive information is a constant need. However, some risks associated with trusted insiders (i.e., employees, consultants, or vendors who are authorized to access the Company’s systems) cannot be fully mitigated using technology or otherwise.
- Unsuspecting employees represent a primary avenue for external parties to gain access to our network and systems. Many attacks, even from sophisticated actors, include rudimentary techniques such as coaxing an internal user to click on a malicious attachment or link to introduce malware or steal their username and password.
- In the past, hackers went after credit and debit card data, which is easy to monetize. As credit card security improves, the hackers will look to other sources of monetization, specifically personally identifiable information or using cyber-attacks or the threat of cyber-attacks to extort money from companies. Insurance and retirement services companies are increasingly being targeted by hackers.
- Nation-state sponsored organizations are engaged in cyber-attacks but not necessarily for monetization purposes. Nation states appear to be motivated by the desire to gain information about foreign citizens and governments or to influence or cause disruptions in commerce or political affairs.
- We have also seen an increase in non-technical attempts to commit fraud or solicit information via call centers and interactive voice response systems, and we anticipate the attempts will become more common.
- We rely on third parties to provide services as described further below. While we have certain standards for all vendors that provide us services, our vendors, and in turn, their own service providers, may become subject to a security breach, including as a result of their failure to perform in accordance with contractual arrangements.

We may not adequately ensure the privacy of sensitive data. In the course of our ordinary business we collect, store and share with various third-parties (e.g., service providers, reinsurers, etc.) substantial amounts of private and confidential policyholder information, including in some instances sensitive health-related information. We are subject to the risk that the privacy of this information may be compromised, including as a result of an information security breach described above.

Third parties (outsourcing providers, vendors and suppliers and joint venture partners) present added operational risk to our enterprise. The Company's business model relies heavily on the use of third parties to deliver contracted services in a broad range of areas. This presents the risk that the Company is unable to meet legal, regulatory, financial or customer obligations because third parties fail to deliver contracted services, or that the Company is exposed to reputational damage because third parties operate in a poorly controlled manner. We use affiliates and third-party vendors located outside the U.S. to provide certain services and functions, which also exposes us to business disruptions and political risks as a result of risks inherent in conducting business outside of the U.S. In our

investments in which we hold a minority interest, or that are managed by third parties, we lack management and operational control over operations, which may subject us to additional operational, compliance and legal risks and prevent us from taking or causing to be taken actions to protect or increase the value of those investments. In those jurisdictions where we are constrained by law from owning a majority interest in jointly owned operations, our remedies in the event of a breach by a joint venture partner may be limited (e.g., we may have no ability to exercise a "call" option).

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Affiliate and third-party distributors of our products present added regulatory, competitive and other risks to our enterprise. Our products are sold primarily through our captive/affiliated distribution models and third-party distributing firms. Our captive/affiliated distribution models are made up of large numbers of decentralized sales personnel who are compensated based on commissions. The third-party distributing firms generally are not dedicated to us exclusively and may frequently recommend and/or market products of our competitors. Accordingly, we must compete intensely for their services. Our sales could be adversely affected if we are unable to attract, retain or motivate third-party distributing firms or if we do not adequately provide support, training, compensation, and education to this sales network regarding our products, or if our products are not competitive and not appropriately aligned with consumer needs. While third-party distributing firms have an independent regulatory accountability, some regulators have been clear with expectations that product manufacturers retain significant sales risk accountability.

In addition, there have been a number of investigations regarding the marketing practices of brokers and agents selling annuity and insurance products and the payments they receive. These investigations have resulted in enforcement actions against companies in our industry and brokers and agents marketing and selling those companies' products. These investigations and enforcement actions could result in penalties and the imposition of corrective action plans and/or changes to industry practices, which could adversely affect our ability to market our products. Furthermore, if our products are distributed in an inappropriate manner, or to customers for whom they are unsuitable, or distributors of our products otherwise engage in misconduct, we may suffer reputational and other harm to our business and be subject to regulatory action.

Although we distribute our products through a wide variety of distribution channels, we do maintain relationships with certain key distributors. For example, a significant amount of our sales in Japan through banks is derived through a single major Japanese bank and a significant portion of our sales in Japan through Life Consultants is derived through a single association relationship. We periodically negotiate the terms of these relationships, and there can be no assurance that such terms will remain acceptable to us or such third parties. An interruption in certain key relationships could materially affect our ability to market our products and could have a material adverse effect on our business, operating results and financial condition. Distributors may elect to reduce or terminate their distribution relationships with us, including for such reasons as adverse developments in our business, adverse rating agency actions or concerns about market-related risks. We are also at risk that key distribution partners may merge, change their business models in ways that affect how our products are sold, or terminate their distribution contracts with us, or that new distribution channels could emerge and adversely impact the effectiveness of our distribution efforts. An increase in bank and broker-dealer consolidation activity could increase competition for access to distributors, result in greater distribution expenses and impair our ability to market products through these channels. Consolidation of distributors and/or other industry changes may also increase the likelihood that distributors will try to renegotiate the terms of any existing selling agreements to terms less favorable to us. Finally, we also may be challenged by new technologies and marketplace entrants that could interfere with our existing relationships.

As a financial services company, we are exposed to model risk, which is the risk of financial loss or reputational damage or adverse regulatory impacts caused by model errors or limitations, incorrect implementation of models, or misuse of or overreliance upon models. Models are utilized by our businesses and corporate areas primarily to project future cash flows associated with pricing products, calculating reserves and valuing assets, as well as in evaluating risk and determining capital requirements, among other uses. These models may not operate properly and may rely on assumptions and projections that are inherently uncertain. As our businesses continue to grow and evolve, the number and complexity of models we utilize expands, increasing our exposure to error in the design, implementation or use of models, including the associated input data and assumptions.

Strategic Risk

We are subject to the risk of events that can cause our fundamental business model to change, either through a shift in the businesses in which we are engaged or a change in our execution.

In addition, tactical risks may become strategic risks. For example, interest rates remaining low for a long time may, at some point, cause us to change our sales goals, exit a certain business, and/or change our business model.

Changes in the regulatory landscape may be unsettling to our business model. New laws and regulations are being considered in the U.S. and our other countries of operation at an increasing pace, as there has been greater scrutiny on financial regulation over the past several years. Proposed or unforeseen changes in law or regulation may adversely impact our business. See "Business—Regulation" for a discussion of certain recently enacted and pending proposals by international, federal and state regulatory authorities and their potential impact on our business, including in the following areas:

- Financial sector regulatory reform.
- Tax laws (including U.S. federal, state, and non-U.S.), including BEAT and GILTI.
- Fiduciary rules and other standards of care.

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- Our regulation under U.S. state insurance laws and developments regarding group-wide supervision and capital standards, RBC factors for invested assets and reserves for life insurance, variable annuities and other products.
- Insurer capital standards in Japan, Korea and other non-U.S. jurisdictions.
- Privacy and cybersecurity regulation.

Changes in accounting rules applicable to our business may also have an adverse impact on our results of operations or financial condition. For a discussion of accounting pronouncements and their potential impact on our business, including Accounting Standards Update ("ASU") 2018-12, Financial Services - Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts, see Note 2 to the Consolidated Financial Statements.

Technological changes may be unsettling to our business model. We believe the following aspects of technological change would significantly impact our business model. There may be other unforeseen changes in technology which may have a significant impact on our business model.

- Interaction with customers. Technology is moving rapidly and as it does, it puts pressure on existing business models. Some of the changes we can anticipate are increased choices about how customers want to interact with the Company or how they want the Company to interact with them. Evolving customer preferences may drive a need to redesign products. Our distribution channels may change to become more automated, at the place and time of the customer's choosing. Such changes clearly have the potential to disrupt our business model over the next 10 years.
- Investment Portfolio. Technology may have a significant impact on the companies in which the Company invests. For example, environmental concerns spur scientific inquiry which may re-position the relative attractiveness of wind or sun power over oil and gas. The transportation industry may favor alternative modes of conveyance of goods which may shift trucking or air transport out of favor. Consumers may change their purchasing behavior to favor online activity which would change the role of malls and retail properties.
- Medical Advances. The Company is exposed to the impact of medical advances in two major ways. Genetic testing and the availability of that information unequally to consumers and insurers can bring anti-selection risks. Specifically, data from genetic testing can give our prospective customers a clearer view into their future, allowing them to select products protecting them against likelihoods of mortality or longevity with more precision. Also, technologies that extend lives will challenge our actuarial assumptions especially in the annuity-based businesses.

Other factors may be unsettling to our business model. The following items are examples of those which, among others, could have a meaningful impact on our business.

- Changes to either the policies and procedures the Company uses to locate guaranteed group annuity customers, or its reserving policies for its guaranteed group annuities, may result in increased operational expenses and complexity, and increases in reserves, which could adversely impact our results of operations and financial position. The Company's retirement business provides guaranteed group annuity benefits under group annuity and structured settlement contracts. Under our policies and procedures, we use internal and external tools and resources to locate customers covered by our guaranteed group annuity benefits. We also have policies on the development of our reserve estimates, and we believe that we are complying with our policies and procedures and meeting our obligations to customers. In light of industry focus on missing retirement customers, the Company has reviewed this issue closely and made enhancements to its processes. In addition, the Company continues to regularly review, test and enhance the processes and tools used to locate customers, and over time, such processes and tools are expected to continue to evolve. However, in the normal course of business, at any given time there are a small number of customers that we cannot locate. Ultimately, we could see greater standardization of what may currently be divergent practices across the industry. Changes to either the policies and procedures the Company uses to locate customers, or its reserving policies, may result in increased operational expenses and complexity, and increases in reserves, which could adversely impact our results of operations and financial position.

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A downgrade in our financial strength or credit ratings could potentially, among other things, adversely impact our business prospects, results of operations, financial condition and liquidity. For a discussion of our ratings and the potential impact of a ratings downgrade on our business, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Ratings." We cannot predict what additional actions rating agencies may take, or what actions we may take in response to the actions of rating agencies, which could adversely affect our business. Our ratings could be downgraded at any time and without notice by any rating agency. In addition, a sovereign downgrade could result in a downgrade of our subsidiaries operating in that jurisdiction, and ultimately of Prudential Financial and our other subsidiaries. For example, in September 2015, S&P downgraded Japan's sovereign rating to A+ with a 'Stable' outlook citing uncertainties around the strength of economic growth and weak fiscal positions. As a result, S&P subsequently lowered the ratings of a number of institutions in Japan, including our Japanese insurance subsidiaries. It is possible that Japan's sovereign rating could be subject to further downgrades, which would result in further downgrades of our insurance subsidiaries in Japan. Given the importance of our operations in Japan to our overall results, such downgrades could lead to a downgrade of Prudential Financial and our domestic insurance companies.

- The elimination of London Inter-Bank Offered Rate ("LIBOR") may adversely affect the interest rates on and value of certain derivatives and floating rate securities we hold and floating rate securities we have issued, the value and profitability of certain real estate lending and other activities conducted in PGIM, and any other assets or liabilities whose value is tied to LIBOR. Actions by regulators have resulted in the establishment of alternative reference rates to LIBOR in most major currencies. On July 27, 2017, the U.K. Financial Conduct Authority announced that it intends to stop persuading or compelling banks to submit LIBOR rates after 2021. However, it remains unclear if, how and in what form, LIBOR will continue to exist. The U.S. Federal Reserve, based on the recommendations of the New York Federal Reserve's Alternative Reference Rate Committee (constituted of major derivative market participants and their regulators), has begun publishing a Secured Overnight Funding Rate ("SOFR") which is intended to replace U.S. dollar LIBOR, and SOFR-based investment products have been issued in the U.S. Proposals for alternative reference rates for other currencies have also been announced or have already begun publication. Markets are slowly developing in response to these new rates and questions around liquidity in these rates and how to appropriately adjust these rates to eliminate any economic value transfer at the time of transition remain a significant concern for us and others in the marketplace. The effect of any changes or reforms to LIBOR or discontinuation of LIBOR on new or existing financial instruments to which we have exposure or the activities in our businesses will vary depending on (1) existing fallback provisions in individual contracts and (2) whether, how, and when industry participants develop and widely adopt new reference rates and fallbacks for both legacy and new products or instruments. Accordingly, it is difficult to predict the full impact of the transition away from LIBOR on certain derivatives and floating rate securities we hold, securities we have issued, real estate lending, and other activities we conduct in PGIM, and any other assets or liabilities, as well as contractual rights and obligations, whose value is tied to LIBOR. The value or profitability of these products and instruments may be adversely affected.

- The changing competitive landscape may adversely affect the Company. In each of our businesses we face intense competition from insurance companies, asset managers and diversified financial institutions, both for the ultimate customers for our products and, in many businesses, for distribution through non-affiliated distribution channels. Technological advances, changing customer expectations, including related to digital offerings, or other changes in the marketplace may present opportunities for new or smaller competitors without established products or distribution channels to meet consumers' increased expectations more efficiently than us. Fintech and insurtech companies have the potential to disrupt industries globally, and many participants have been partially funded by industry players. For example, in PGIM, we expect to see continued pressure on fees given the focus on passive investment and the growth of the robo-advice channel.

- Climate change may increase the severity and frequency of calamities, or adversely affect our investment portfolio. Climate change may increase the frequency and severity of weather related disasters and pandemics. In addition, climate change regulation may affect the prospects of companies and other entities whose securities we hold, or our willingness to continue to hold their securities. It may also impact other counterparties, including reinsurers, and affect the value of investments, including real estate investments we hold or manage for others. We cannot predict the

long-term impacts on us from climate change or related regulation.

- Market conditions and other factors may adversely impact product sales or increase expenses. Examples include:

A change in market conditions, such as high inflation and high interest rates, could cause a change in consumer sentiment and behavior adversely affecting sales and persistency of our savings and protection products. Conversely, low inflation and low interest rates could cause persistency of these products to vary from that anticipated and adversely affect profitability. Similarly, changing economic conditions and unfavorable public perception of financial institutions can influence customer behavior, including increasing claims or surrenders in certain products.

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- Sales of our investment-based and asset management products and services may decline, and lapses and surrenders of certain insurance products and withdrawals of assets from investment products may increase if a market downturn, increased market volatility or other market conditions result in customers becoming dissatisfied with their investments or products.
- Changes in our discount rate, expected rate of return, life expectancy, health care cost and assumptions regarding compensation increases for our pension and other postretirement benefit plans may result in increased expenses and reduce our profitability.
- Our reputation may be adversely impacted if any of the risks described in this section are realized. Reputational risk could manifest from any of the risks as identified in the Company's risk identification process. Failure to effectively manage risks across a broad range of risk issues exposes the Company to reputational harm. If the Company were to suffer a significant loss in reputation, both policyholders and counterparties could seek to exit existing relationships. Additionally, large changes in credit worthiness, especially credit ratings, could impact access to funding markets while creating additional collateral requirements for existing relationships. The mismanagement of any such risks may potentially damage our reputational asset. Our business is anchored in the strength of our brand, our alignment to our values, and our proven commitment to keep our promises to our customers. Any negative public perception, founded or otherwise, can be widely and rapidly shared over social media or other means, and could cause damage to our reputation.

## ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

## ITEM 2. PROPERTIES

We own our headquarters building located at 751 Broad Street, Newark, New Jersey, which comprises approximately 0.6 million square feet. Excluding our headquarters building and properties used by the International Insurance division and the international investment operations of our PGIM segment, which are discussed below, as of December 31, 2018, we own eight and lease eleven other principal properties throughout the U.S., some of which are used for home office functions. Our domestic operations also lease 189 other locations throughout the U.S.

For our International Insurance segment, as of December 31, 2018, we own five home offices located in Japan, Korea, Taiwan, Brazil and Argentina, and lease four home offices located in Brazil, Italy, Mexico and Malaysia. We also own approximately 100 and lease approximately 530 other properties, primarily field offices, located throughout these same countries. For our PGIM segment, which includes our international investment operations, as of December 31, 2018, we lease two home offices located in Japan and Taiwan. We also lease 12 international principal properties located in Mexico, Japan, Hong Kong, Singapore, Korea, Germany, Australia, France, Luxembourg, the U.K. and China, in addition to six other branch and field offices within Europe and Asia.

We believe our properties are adequate and suitable for our business as currently conducted and are adequately maintained. The above properties do not include properties we own solely for investment purposes.

## ITEM 3. LEGAL PROCEEDINGS

See Note 22 to the Consolidated Financial Statements under "—Litigation and Regulatory Matters" for a description of certain pending litigation and regulatory matters affecting us, and certain risks to our businesses presented by such matters.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

General

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Prudential Financial's Common Stock trades on the New York Stock Exchange under the symbol "PRU." On January 31, 2019, there were 1,257,264 registered holders of record for the Common Stock and 409 million shares outstanding.

Issuer Purchases of Equity Securities

The following table provides information about purchases by the Company during the three months ended December 31, 2018, of its Common Stock.

| Period | Total Number of Shares Purchased(1) | 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(2) |
|---|---|---|---|---|
| October 1, 2018 through October 31, 2018 | 1,279,296 | $ 98.33 | 1,271,136 | |
| November 1, 2018 through November 30, 2018 | 1,332,660 | $ 93.98 | 1,329,967 | |
| December 1, 2018 through December 31, 2018 | 1,489,122 | $ 84.10 | 1,486,327 | |
| Total | 4,101,078 | $ 91.75 | 4,087,430 | $ 0 |

(1) Includes shares of Common Stock withheld from participants for income tax withholding purposes whose shares of restricted stock units vested during the period. Such restricted stock units were originally issued to participants pursuant to the Prudential Financial Inc. Omnibus Incentive Plan.

(2) In December 2017, 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 during the period from January 1, 2018 through December 31, 2018.

In December 2018, Prudential Financial's Board of Directors authorized the Company to repurchase, at management's discretion, up to $2.0 billion of its outstanding Common Stock during the period from January 1, 2019 through December 31, 2019.

## ITEM 6. SELECTED FINANCIAL DATA

We derived the selected consolidated income statement data for the years ended December 31, 2018, 2017 and 2016 and the selected consolidated balance sheet data as of December 31, 2018 and 2017, from our Consolidated Financial Statements included elsewhere herein. We derived the selected consolidated income statement data for the years ended December 31, 2015 and 2014, and the selected consolidated balance sheet data as of December 31, 2016, 2015 and 2014, from consolidated financial statements not included herein.

Prior to January 1, 2018, the Company's Gibraltar Life Insurance Company, Ltd. ("Gibraltar Life") consolidated operations used a November 30 fiscal year end for purposes of inclusion in the Company's Consolidated Financial Statements. The result of this reporting date difference was a one-month reporting lag for Gibraltar Life. As a result, the Company's consolidated balance sheet as of December 31 previously included the assets and liabilities of Gibraltar Life as of November 30 for each respective year, and the Company's consolidated income statement data for the years ended December 31 included Gibraltar Life's results of operations for the twelve months ended November 30 for each respective year.

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

This selected consolidated financial information should be read in conjunction with our MD&A and Consolidated Financial Statements included elsewhere herein.

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2018 | 2017 | 2016 | 2015 | 2014 |
| | (in millions, except per share and ratio information) | | | | |
| Income Statement Data: | | | | | |
| Revenues: | | | | | |
| Premiums | $35,779 | $32,091 | $30,964 | $28,521 | $29,293 |
| Policy charges and fee income | 6,002 | 5,303 | 5,906 | 5,972 | 6,179 |
| Net investment income | 16,176 | 16,435 | 15,520 | 14,829 | 15,256 |
| Asset management and service fees | 4,100 | 4,127 | 3,752 | 3,772 | 3,719 |
| Other income (loss) | (1,042) | 1,301 | 443 | 0 | (1,978) |
| Realized investment gains (losses), net | 1,977 | 432 | 2,194 | 4,025 | 1,636 |
| Total revenues | 62,992 | 59,689 | 58,779 | 57,119 | 54,105 |
| Benefits and expenses: | | | | | |
| Policyholders' benefits | 39,404 | 33,794 | 33,632 | 30,627 | 31,587 |
| Interest credited to policyholders' account balances | 3,196 | 3,822 | 3,761 | 3,479 | 4,263 |
| Dividends to policyholders | 1,336 | 2,091 | 2,025 | 2,212 | 2,716 |
| Amortization of deferred policy acquisition costs | 2,273 | 1,580 | 1,877 | 2,120 | 1,973 |
| General and administrative expenses | 11,949 | 11,915 | 11,779 | 10,912 | 11,807 |
| Total benefits and expenses | 58,158 | 53,202 | 53,074 | 49,350 | 52,346 |
| Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures | 4,834 | 6,487 | 5,705 | 7,769 | 1,759 |
| Total income tax expense (benefit) | 822 | (1,438) | 1,335 | 2,072 | 349 |
| Income (loss) from continuing operations before equity in earnings of operating joint ventures | 4,012 | 7,925 | 4,370 | 5,697 | 1,410 |
| Equity in earnings of operating joint ventures, net of taxes | 76 | 49 | 49 | 15 | 16 |
| Income (loss) from continuing operations | 4,088 | 7,974 | 4,419 | 5,712 | 1,426 |
| Income (loss) from discontinued operations, net of taxes | 0 | 0 | 0 | 0 | 12 |
| Net income (loss) | 4,088 | 7,974 | 4,419 | 5,712 | 1,438 |
| Less: Income (loss) attributable to noncontrolling interests | 14 | 111 | 51 | 70 | 57 |
| Net income (loss) attributable to Prudential Financial, Inc. | $4,074 | $7,863 | $4,368 | $5,642 | $1,381 |
| EARNINGS PER SHARE(1) | | | | | |
| Basic earnings per share—Common Stock: | | | | | |
| Income (loss) from continuing operations attributable to Prudential Financial, Inc. | $9.64 | $18.19 | $9.85 | $12.37 | $3.23 |
| Income (loss) from discontinued operations, net of taxes | 0.00 | 0.00 | 0.00 | 0.00 | 0.02 |
| Net income (loss) attributable to Prudential Financial, Inc. | $9.64 | $18.19 | $9.85 | $12.37 | $3.25 |
| Diluted earnings per share—Common Stock: | | | | | |
| Income (loss) from continuing operations attributable to Prudential Financial, Inc. | $9.50 | $17.86 | $9.71 | $12.17 | $3.20 |
| Income (loss) from discontinued operations, net of taxes | 0.00 | 0.00 | 0.00 | 0.00 | 0.03 |
| Net income (loss) attributable to Prudential Financial, Inc. | $9.50 | $17.86 | $9.71 | $12.17 | $3.23 |
| Dividends declared per share—Common Stock | $3.60 | $3.00 | $2.80 | $2.44 | $2.17 |

(1) For 2018, 2017, 2016 and 2015, represents consolidated earnings per share of Common Stock. For 2014, represents earnings of the Company's former Financial Services Businesses per share of Common Stock.

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| | As of December 31, | | | | |
|---|---|---|---|---|---|
| | 2018 | 2017 | 2016 | 2015 | 2014 |
| | (in millions) | | | | |
| Balance Sheet Data: | | | | | |
| Total investments excluding policy loans | $467,229 | $457,980 | $432,485 | $405,535 | $408,274 |
| Separate account assets | 279,136 | 306,617 | 287,636 | 285,570 | 296,435 |
| Total assets | 815,078 | 832,136 | 784,177 | 757,470 | 766,526 |
| Future policy benefits and policyholders' account balances | 424,184 | 405,506 | 386,113 | 361,168 | 353,916 |
| Separate account liabilities | 279,136 | 306,617 | 287,636 | 285,570 | 296,435 |
| Short-term debt | 2,451 | 1,380 | 1,133 | 1,216 | 3,839 |
| Long-term debt | 17,378 | 17,172 | 18,041 | 19,594 | 19,702 |
| Total liabilities | 766,047 | 777,625 | 737,922 | 715,380 | 724,177 |
| Prudential Financial, Inc. equity | 48,617 | 54,236 | 46,030 | 42,057 | 41,770 |
| Noncontrolling interests | 414 | 275 | 225 | 33 | 579 |
| Total equity | $49,031 | $54,511 | $46,255 | $42,090 | $42,349 |

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## ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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Certain of the statements included in this section constitute forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements are made based on management's current expectations and beliefs concerning future developments and their potential effects upon Prudential Financial, Inc. and its subsidiaries. Prudential Financial, Inc.'s actual results may differ, possibly materially, from expectations or estimates reflected in such forward-looking statements. Certain important factors that could cause actual results to differ, possibly materially, from expectations or estimates reflected in such forward-looking statements can be found in the "Risk Factors" and "Forward-Looking Statements" sections herein.

Overview

Our principal operations are comprised of five divisions, which together encompass seven segments, and our Corporate and Other operations. The PGIM division is comprised of our PGIM segment (formerly named the Investment Management segment). The U.S. Workplace Solutions division consists of our Retirement and Group Insurance segments. The U.S. Individual Solutions division consists of our Individual Annuities and Individual Life segments. The International Insurance division consists of our International Insurance segment, and the Closed Block division consists of our Closed Block segment. Our Corporate and Other operations include corporate items and initiatives that are not allocated to business segments and businesses that have been or will be divested or placed in run-off.

Revenues and Expenses

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

Profitability

Our profitability depends principally on our ability to price our insurance and annuity products at a level that enables us to earn a margin over the costs associated with providing benefits and administering those products. Profitability also depends on, among other items, our actuarial and policyholder behavior experience on insurance and annuity products, and our ability to attract and retain customer assets, generate and maintain favorable investment results, effectively deploy capital and utilize our tax capacity, and manage expenses.

Historically, the participating products included in the Closed Block have yielded lower returns on capital invested than many of our other businesses. As we have ceased offering domestic participating products, we expect that the proportion of the traditional participating products in our in-force business will gradually diminish as these older policies age, and we grow other businesses. However, the relatively lower returns to us on this existing block of business will continue to affect our consolidated results of operations for many years.

Outlook

Management expects that results in 2019 will continue to benefit from our differentiated mix of market-leading businesses that complement each other to provide competitive advantages. Our mix of high-quality protection, retirement and investment management businesses creates growth potential due to earnings diversification and the opportunity to provide customers with integrated cross-business solutions, as well as capital benefits from a balanced risk profile. While challenges exist in the form of a low interest rate environment (see “Impact of a Low Interest Rate Environment”), fee compression in certain of our businesses and other market factors, we expect that our choice of businesses coupled with strong execution will produce attractive returns.

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We are well positioned to meet the needs of customers and tap into significant market opportunities through our U.S. Financial Wellness businesses, PGIM, our investment management business and our International Insurance business. U.S. Financial Wellness represents our Workplace Solutions and Individual Solutions businesses. We see an opportunity to address the evolving needs of individual customers, workplace clients, and society at large through our increasingly important financial wellness solutions. We possess the key components to execute on this strategy, including a workplace platform covering twenty million individuals; solutions that cover protection, retirement, savings, income, and investment needs; and a customer-centric approach with different ways to engage with our clients through multiple channels such as meeting with one of our financial advisors, calling or video-conferencing with an advisor, or interacting with us in a purely digital manner. Our goal is to meet our customers' needs when, where and how they want. By leveraging technology and our scale, we can significantly expand the addressable market, build deeper and longer-lasting relationships with customers and clients, and make a meaningful difference in the financial wellness of their lives.

PGIM has also produced differentiated outcomes with strong investment performance that has led to consistently positive annual net institutional flows over the past sixteen years. In addition to providing solutions for its third-party clients, PGIM provides our U.S. Financial Wellness and International Insurance businesses with a competitive advantage through its investment expertise across a broad array of asset classes, including specialty classes such as real estate, private placements, and commercial mortgages.

Our International Insurance business includes our world-class Japanese life insurance operation and investments in high-growth markets with large populations such as Brazil, India, Indonesia and China. We approach these markets in a differentiated way, and that has led to steady overall growth, attractive returns and significant capital generation.

In summary, we feel confident about our prospects for the future supported by our integrated and complementary businesses. Specific outlook considerations for each of our businesses include the following:

- U.S. Workplace Solutions. In our Retirement business we continue to provide products that respond to the needs of plan sponsors to manage risk and control their benefit costs, while ensuring we maintain appropriate pricing and return expectations under changing market conditions. Our differentiated capabilities and demonstrated execution in the pension risk transfer business is expected to continue to generate attractive growth opportunities. We expect, however, that growth will not be linear given the episodic nature of larger cases, which is the segment of the market where we are most competitive and where the returns are the most compelling. In addition, while we foresee continuation of the spread and fee compression that we have been experiencing in our full-service business, we believe these are manageable headwinds. In our Group Insurance business, we are focused on expanding our Premier market segment, while maintaining a leadership position in the national segment. We are seeing benefits from our multi-year underwriting efforts, especially in our disability business where improved claims management and our continued pricing discipline have resulted in improvements to our benefits ratio. In both Retirement and Group Insurance, we believe our Financial Wellness platform provides meaningful differentiation in the market and is helping us build deeper customer relationships.

- U.S. Individual Solutions. Our Individual Annuities business remains focused on helping its customers meet their investment and retirement needs. We expect continued strong results and stable free cash flows, with near-term returns on assets above our long-term target. We expect to incur costs associated with our enhanced risk management strategy, but this program is expected to produce less volatile net income and cash flows, particularly in adverse scenarios. In addition, we expect a natural reduction in average fee rates due to the maturation of the existing block and due to sales of newer products which generally have lower rate structures. We expect the combination of these factors to cause our returns on assets to migrate to the long-term target over time. We continue to execute on our product diversification strategy and remain focused on a broad range of outcome-oriented solutions for customers. Our Individual Life business is continuing to execute on its product diversification strategy in order to maintain a

diversified product mix and an attractive risk profile. We continue to deepen relationships with distribution partners while developing a more customer-oriented experience. Recent product actions could result in a slightly higher portion of sales in term and variable life as we remain committed to achieving a diversified product offering.

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- PGIM. Our investment management business is focused on maintaining strong investment performance while leveraging both the scale of its approximately $1.2 trillion distinctive multi-manager model and Prudential enterprise relationships. PGIM is making targeted investments to further diversify its product offerings, expand its global investment and distribution footprint, selectively acquire new investment capabilities, and further strengthen external recognition as a leading global asset manager. These capabilities will enable PGIM to continue to meet our clients' evolving needs and, in turn, to generate flows across multiple asset classes, client segments and geographies. Underpinning our growth strategy is our ability to continue to deliver robust investment performance, and to attract and retain high-caliber investment talent. While we are experiencing fee pressures, our average fee yield has remained relatively flat due to new flows coming into higher fee yielding strategies within fixed income, equities and alternatives such as real estate and private fixed income, and because of our diverse business profile.

- International Insurance. We continue to concentrate on deepening our presence in Japan and other markets in which we currently operate and expanding our distribution capabilities in emerging markets. We continue to focus on protection solutions and innovate as clients' needs evolve. The returns on our death protection products are largely driven by mortality margins which helps mitigate the exposure of results to interest rates. We have seen a shift in sales mix with a greater emphasis on U.S. dollar-denominated products in Japan. We expect this trend to continue. We are also focused on achieving scale in select growth markets outsides of Japan. With regard to distribution, we are seeking to grow Life Planners in all countries where that model exists and to strategically expand the Bank and Independent Agency channel, however we may see a decline in Gibraltar Life Insurance Company, Ltd. ("Gibraltar Life") Consultants as we continue to focus on increasing quality and productivity standards.

In order to capitalize on the growth opportunities in our domestic and international markets highlighted above, we continue to make investments in and across our businesses. These investments are focused on product development, distribution and technology. We are investing in product innovation through the use of data and digital initiatives to better understand and serve the needs of a customer base with changing demographics and to achieve a goal of offering a broader array of cost effective and easily comprehensible products. We are investing in expanding our distribution capabilities through a focus on customer experience and technology enabled advice and distribution, cross-business collaboration, further development of work site relationships with individuals and expanding our ability to offer relevant products and services to customers through whichever channels they choose. In addition, we are making investments in our information technology infrastructure in order to streamline processes and enhance the effectiveness of our administrative systems.

While we expect these strategic investments to ultimately generate business growth, they may result in elevated expenses in the near term. In addition, we expect the time periods required for these investments to generate returns to vary. These investments are being funded through a combination of operating cost efficiencies and the returns generated by our businesses, and we expect to be able to continue to absorb some of these investment costs through efficiency gains.

Industry Trends

Our U.S. and international businesses are impacted by financial markets, economic conditions, regulatory oversight, and a variety of trends that affect the industries where we compete.

Financial and Economic Environment.

U.S. Businesses - As discussed further under "Impact of a Low Interest Rate Environment" below, interest rates in the U.S. remain lower than historical levels, which may continue to negatively impact our portfolio income yields and our net investment spread results. In addition, we are subject to financial impacts associated with movements in equity

markets and the evolution of the credit cycle as discussed in “Segment Results of Operations” where applicable and more broadly in “Risk Factors”.

International Businesses - Our international insurance operations, especially in Japan, continue to operate in a low interest rate environment. Although the local market in Japan has adapted to low interest rates, as discussed under “Impact of a Low Interest Rate Environment” below, the current reinvestment yields for certain blocks of business in our international insurance operations are now generally lower than the current portfolio yield supporting these blocks of business, which may negatively impact our net investment spread results. The continued low interest rate environment in the U.S. may also impact the relative attractiveness of U.S. dollar-denominated products to yen-denominated products in Japan. In addition, we are subject to financial impacts associated with movements in foreign currency rates, particularly the Japanese yen. Fluctuations in the value of the yen will continue to impact the relative attractiveness of both yen-denominated and non-yen denominated products. In addition, we are subject to financial impacts associated with movements in equity markets and the evolution of the credit cycle as discussed in “Segment Results of Operations” where applicable and more broadly in “Risk Factors”.

Demographics.

U.S. Businesses - Customer demographics continue to evolve and new opportunities present themselves in different consumer segments such as the millennial and multicultural markets. Consumer expectations and preferences are changing. We believe existing customers and potential customers are increasingly looking for cost-effective solutions that they can easily understand and access through technology-enabled devices. At the same time, income protection, wealth accumulation and the needs of retiring baby boomers are continuing to shape the insurance industry. A persistent retirement security gap exists in terms of both savings and protection. Despite the ongoing phenomenon of the risk and responsibility of retirement savings shifting from employers to employees, employers are becoming increasingly focused on the financial wellness of the individuals they employ.

International Businesses- Japan has an aging population as well as a large pool of household assets invested in low-yielding deposit and savings vehicles. The aging of Japan’s population, along with strains on government pension programs, have led to a growing demand for insurance products with a significant savings element to meet savings and retirement needs as the population prepares for retirement. We are seeing a similar shift to retirement-oriented products across other Asian markets, including Korea and Taiwan, each of which also has an aging population.

Regulatory Environment. See “Business—Regulation” for a discussion of regulatory developments that may impact the Company and the associated risks.

Competitive Environment. See “Business—” for a discussion of the competitive environment and the basis on which we compete in each of our segments.

Impact of a Low Interest Rate Environment

As a global financial services company, market interest rates are a key driver of our results of operations and financial condition. Changes in interest rates can affect our results of operations and/or our financial condition in several ways, including favorable or adverse impacts to:

- investment-related activity, including: investment income returns, net interest margins, net investment spread results, new money rates, mortgage loan prepayments and bond redemptions;
- insurance reserve levels, market experience true-ups and amortization of both deferred policy acquisition costs (“DAC”) and value of business acquired (“VOBA”);
- customer account values, including their impact on fee income;
- fair value of, and possible impairments on, intangible assets such as goodwill;
- product offerings, design features, crediting rates and sales mix; and
- policyholder behavior, including surrender or withdrawal activity.

See below for discussions related to the current interest rate environments in our two largest markets, the United States and Japan; the composition of our insurance liabilities and policyholder account balances; and the hypothetical impacts to our results if these interest rate environments are sustained.

U.S. Operations excluding the Closed Block Division

Interest rates in the U.S. have experienced a period of historically low levels in large part due to Federal Reserve efforts to assist with the economic recovery subsequent to the financial crisis of 2008. However, more recently market interest rates have begun to climb in conjunction with a series of Federal Reserve decisions to raise interest rates in response to a strengthening economy. While market conditions and events make uncertain the timing, amount and impact of any further monetary policy decisions by the Federal Reserve, a trend of rising interest rates may enhance

our reinvestment yields, primarily for our investments in fixed maturity securities and commercial mortgage loans. As interest rates rise, our reinvestment yield may approach or exceed the overall portfolio yield. Conversely, if interest rates were to decline, our reinvestment yield may fall below our overall portfolio yield, resulting in an unfavorable impact to earnings.

For the general account supporting our U.S. Individual Solutions division, U.S. Workplace Solutions division, PGIM division and our Corporate and Other operations, we estimate annual principal payments and prepayments that we would be required to reinvest to be approximately 6.0% of the fixed maturity security and commercial mortgage loan portfolios through 2020. The portion of the general account attributable to these operations has approximately $198 billion of such assets (based on net carrying value) as of December 31, 2018. The average portfolio yield for fixed maturity securities and commercial mortgage loans is approximately 4.3%, as of December 31, 2018.

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Included in the $198 billion of fixed maturity securities and commercial mortgage loans are approximately $113 billion that are subject to call or redemption features at the issuer's option and have a weighted average interest rate of approximately 4%. Of this $113 billion, approximately 64% contain provisions for prepayment premiums. If we reinvest scheduled payments or prepayments (not subject to a prepayment fee) at rates below the current portfolio yield, including in some cases at rates below those guaranteed under our insurance contracts, future operating results will be impacted to the extent we do not, or are unable to, reduce crediting rates on in-force blocks of business, or effectively utilize other asset/liability management strategies described below, in order to maintain current net interest margins.

The following table sets forth the insurance liabilities and policyholder account balances of our U.S. Operations excluding the Closed Block Division, by type, for the date indicated:

| | As of December 31, 2018 (in billions) |
|---|---|
| Long-duration insurance products with fixed and guaranteed terms | $ 124 |
| Contracts with adjustable crediting rates subject to guaranteed minimums | 57 |
| Participating contracts where investment income risk ultimately accrues to contractholders | 15 |
| Total | $ 196 |

The $124 billion above relates to long-duration products such as group annuities, structured settlements and other insurance products that have fixed and guaranteed terms, for which underlying assets may have to be reinvested at interest rates that are lower than portfolio rates. We seek to mitigate the impact of a prolonged low interest rate environment on these contracts through asset/liability management, as discussed further below.

The $57 billion above relates to contracts with crediting rates that may be adjusted over the life of the contract, subject to guaranteed minimums. Although we may have the ability to lower crediting rates for those contracts above guaranteed minimums, our willingness to do so may be limited by competitive pressures. The following table sets forth the related account values by range of guaranteed minimum crediting rates and the related range of the difference, in basis points ("bps"), between rates being credited to contractholders as of December 31, 2018, and the respective guaranteed minimums.

| | Account Values with Adjustable Crediting Rates Subject to Guaranteed Minimums: | | | | | |
|---|---|---|---|---|---|---|
| | At guaranteed minimum | 1-49 bps above guaranteed minimum | 50-99 bps above guaranteed minimum | 100-150 bps above guaranteed minimum | Greater than 150 bps above guaranteed minimum | Total |
| | ($ in billions) | | | | | |
| Range of Guaranteed Minimum Crediting Rates: | | | | | | |
| Less than 1.00% | $0.5 | $ 1.2 | $ 0.5 | $ 0.1 | $ 0.0 | $2.3 |
| 1.00% - 1.99% | 1.0 | 4.1 | 11.1 | 2.1 | 0.6 | 18.9 |
| 2.00% - 2.99% | 1.3 | 0.7 | 1.9 | 1.1 | 0.7 | 5.7 |
| 3.00% - 4.00% | 26.7 | 2.0 | 0.2 | 0.2 | 0.0 | 29.1 |
| Greater than 4.00% | 0.9 | 0.0 | 0.0 | 0.0 | 0.0 | 0.9 |
| Total(1) | $30.4 | $ 8.0 | $ 13.7 | $ 3.5 | $ 1.3 | $56.9 |

| Percentage of total | 54 % | 14 % | 24 % | 6 % | 2 % | 100 % |
|---|---|---|---|---|---|---|

(1) Includes approximately $0.85 billion related to contracts that impose a market value adjustment if the invested amount is not held to maturity.

The remaining $15 billion of insurance liabilities and policyholder account balances in these operations relates to participating contracts for which the investment income risk is expected to ultimately accrue to contractholders. The crediting rates for these contracts are periodically adjusted based on the return earned on the related assets.

Assuming a hypothetical scenario where the average 10-year U.S. Treasury rate is 2.70% for the period from January 1, 2019 through December 31, 2019, and credit spreads remain unchanged from levels as of December 31, 2018, we estimate that the impact to pre-tax adjusted operating income of reinvesting in such an environment, compared to reinvesting at current average portfolio yields, would not be significant.

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In order to mitigate the unfavorable impact that a low interest rate environment has on our net interest margins, we employ a proactive asset/liability management program, which includes strategic asset allocation and hedging strategies within a disciplined risk management framework. These strategies seek to match the characteristics of our products, and to closely approximate the interest rate sensitivity of the assets with the estimated interest rate sensitivity of the product liabilities. Our asset/liability management program also helps manage duration gaps, currency and other risks between assets and liabilities through the use of derivatives. We adjust this dynamic process as products change, as customer behavior changes and as changes in the market environment occur. As a result, our asset/liability management process has permitted us to manage the interest rate risk associated with our products through several market cycles. Our interest rate exposure is also mitigated by our business mix, which includes lines of business for which fee-based and insurance underwriting earnings play a more prominent role in product profitability.

Closed Block Division

Substantially all of the $58 billion of general account assets in the Closed Block division support obligations and liabilities relating to the Closed Block policies only. See Note 14 to the Consolidated Financial Statements for further information on the Closed Block.

International Insurance Operations

While our international insurance operations have experienced a low interest rate environment for many years, the current reinvestment yields for certain blocks of business in our international insurance operations are generally lower than the current portfolio yield supporting these blocks of business. In recent years, the Bank of Japan’s monetary policy has resulted in even lower and, at times, negative yields for certain tenors of government bonds. Our international insurance operations employ a proactive asset/liability management program in order to mitigate, to the extent possible, the unfavorable impact that the current interest rate environment has on our net interest margins. In conjunction with this program, we have not purchased negative yielding assets to support the portfolio and we continue to purchase long-term bonds with tenors of 30 years or greater. Additionally, our diverse product portfolio in terms of currency mix and premium payment structure allows us to further mitigate the negative impact from this low interest rate environment. We regularly examine our product offerings and their profitability. As a result, we have repriced certain products, adjusted commissions for certain products and have discontinued sales of other products that do not meet our profit expectations. The impact of these actions, coupled with the strengthening of the yen against the U.S. dollar and introduction of certain new products, has resulted in an increase in sales of U.S. dollar-denominated products relative to products denominated in other currencies. For additional information on sales within our international insurance operations, see “—International Insurance Division—International Insurance—Sales Results,” below.

The following table sets forth the insurance liabilities and policyholder account balances of our Japanese operations, by type, for the date indicated:

| | As of December 31, 2018 (in billions) |
|---|---|
| Long-duration insurance products with fixed and guaranteed terms | $ 120 |
| Contracts with a market value adjustment if invested amount is not held to maturity | 26 |
| Contracts with adjustable crediting rates subject to guaranteed minimums | 10 |
| Total | $ 156 |

The $120 billion above is predominantly comprised of long-duration insurance products that have fixed and guaranteed terms, for which underlying assets may have to be reinvested at interest rates that are lower than current portfolio yields. The remaining insurance liabilities and policyholder account balances include $26 billion related to contracts that impose a market value adjustment if the invested amount is not held to maturity and $10 billion related to contracts with crediting rates that may be adjusted over the life of the contract, subject to guaranteed minimums. Most of the current crediting rates on these contracts, however, are at or near contractual minimums. Although we have the ability in some cases to lower crediting rates for those contracts that are above guaranteed minimum crediting rates, the majority of this business has interest crediting rates that are determined by formula.

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Assuming a hypothetical scenario within our Japanese and Korean operations where new money yields would be 25 bps lower than projected, and applying these lower new money yields to annualized investment of renewal premiums, proceeds from investment disposition and reinvestment of investment income, we estimate that the unfavorable impact would reduce adjusted operating income in 2019 by approximately $10 to $15 million. This hypothetical scenario excludes first-year premium, single pay premium, multi-currency fixed annuity cash flows, any potential benefit from repricing products and any impact from other factors, including but not limited to new business, contractholder behavior, changes in competitive conditions, changes in capital markets and the effect of derivative instruments.

Results of Operations

Consolidated Results of Operations

The following table summarizes net income (loss) for the periods presented.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | (in millions) | | |
| Revenues | $62,992 | $59,689 | $58,779 |
| Benefits and expenses | 58,158 | 53,202 | 53,074 |
| Income (loss) before income taxes and equity in earnings of operating joint ventures | 4,834 | 6,487 | 5,705 |
| Income tax expense (benefit) | 822 | (1,438) | 1,335 |
| Income (loss) before equity in earnings of operating joint ventures | 4,012 | 7,925 | 4,370 |
| Equity in earnings of operating joint ventures, net of taxes | 76 | 49 | 49 |
| Net income (loss) | 4,088 | 7,974 | 4,419 |
| Less: Income attributable to noncontrolling interests | 14 | 111 | 51 |
| Net income (loss) attributable to Prudential Financial, Inc. | $4,074 | $7,863 | $4,368 |

2018 to 2017 Annual Comparison. The $3,789 million decrease in “Net income (loss) attributable to Prudential Financial, Inc.” reflected the following notable items:

- $3,693 million unfavorable variance, primarily reflecting tax expense in the current year compared to a tax benefit in the prior year due to the impact of tax reform and certain other tax matters (see Note 15 to the Consolidated Financial Statements for additional information);

- $1,427 million unfavorable variance, on a pre-tax basis, from adjustments to reserves as well as DAC and other costs, reflecting updates to the estimated profitability of our businesses, including the impact of our annual reviews and update of assumptions and other refinements. This excludes the impact associated with the variable annuity hedging program discussed below (see “—Results of Operations by Segment—U.S. Individual Solutions Division—Individual Annuities” for additional information); and

- $221 million unfavorable variance, on a pre-tax basis, from a loss in the current period from our Divested and Run-off Businesses compared to income in the prior period, excluding the impact of our annual reviews and update of assumptions and other refinements, as discussed above.

Partially offsetting these decreases in “Net income (loss) attributable to Prudential Financial, Inc.” were the following items:

•

- $917 million favorable variance from net pre-tax realized investment gains and losses for PFI excluding the Closed Block division, excluding the impact of the hedging program associated with certain variable annuities discussed below (see "—General Account Investments" for additional information); and

- $635 million favorable variance, on a pre-tax basis, reflecting the net impact from changes in the value of our embedded derivatives and related hedge positions associated with certain variable annuities (see "—Results of Operations by Segment—U.S. Individual Solutions Division—Individual Annuities—Variable Annuity Risks and Risk Mitigants" for additional information).

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2017 to 2016 Annual Comparison. The $3,495 million increase in “Net income (loss) attributable to Prudential Financial, Inc.” reflected the following notable items:

- $2,773 million favorable impact reflecting a tax benefit in 2017 compared to a tax expense in 2016 primarily as a result of tax reform (see Note 15 to the Consolidated Financial Statements for additional information);
- $1,927 million net favorable variance, on a pre-tax basis, primarily from higher operating results from our business segments and income in 2017 from our Divested and Run-off Businesses compared to a loss in 2016;
- $1,500 million favorable variance, on a pre-tax basis, reflecting changes to the way we manage interest rate risks for certain products. This variance is primarily attributed to changes in our Individual Annuities risk management strategy implemented in 2016, whereby we terminated the existing intercompany derivative transactions between our Corporate and Other operations and Individual Annuities related to managing interest rate risk and we now manage this risk within the Individual Annuities business segment (see “—Results of Operations by Segment—Corporate and Other—Capital Protection Framework” for additional information); and
- $478 million favorable variance, on a pre-tax basis, from adjustments to DAC and other costs as well as reserves, reflecting updates to the estimated profitability of our businesses, including the impact of our annual reviews and update of assumptions and other refinements. This excludes the impact associated with the variable annuity hedging program discussed below (see “—Results of Operations by Segment—U.S. Individual Solutions Division—Individual Annuities” for additional information).

Partially offsetting these increases in “Net income (loss) attributable to Prudential Financial, Inc.” were the following items:

- $2,373 million unfavorable variance, on a pre-tax basis, reflecting the net impact from changes in the value of our embedded derivatives and related hedge positions associated with certain variable annuities (see “—Results of Operations by Segment—U.S. Individual Solutions Division—Individual Annuities—Variable Annuity Risks and Risk Mitigants” for additional information); and
- $810 million lower net pre-tax realized gains for PFI excluding the Closed Block division, and excluding the impact of the hedging program associated with certain variable annuities discussed above (see “—General Account Investments” for additional information).

Segment Results of Operations

We analyze the performance of our segments and Corporate and Other operations using a measure of segment profitability called adjusted operating income. See “—Segment Measures” for a discussion of adjusted operating income and its use as a measure of segment operating performance.

Shown below are the adjusted operating income contributions of each segment and Corporate and Other operations for the periods indicated and a reconciliation of this segment measure of performance to “Income (loss) before income taxes and equity in earnings of operating joint ventures” as presented in our Consolidated Statements of Operations.

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| | Year ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | (in millions) | | |
| Adjusted operating income before income taxes by segment: | | | |
| PGIM | $959 | $979 | $787 |
| Total PGIM division | 959 | 979 | 787 |
| Retirement | 1,049 | 1,244 | 1,012 |
| Group Insurance | 229 | 253 | 220 |
| Total U.S. Workplace Solutions division | 1,278 | 1,497 | 1,232 |
| Individual Annuities | 1,925 | 2,198 | 1,765 |
| Individual Life | 223 | (191 ) | 79 |
| Total U.S. Individual Solutions division | 2,148 | 2,007 | 1,844 |
| International Insurance | 3,266 | 3,198 | 3,117 |
| Total International Insurance division | 3,266 | 3,198 | 3,117 |
| Corporate and Other operations | (1,283 ) | (1,437 ) | (1,581 ) |
| Total Corporate and Other | (1,283 ) | (1,437 ) | (1,581 ) |
| Total segment adjusted operating income before income taxes | 6,368 | 6,244 | 5,399 |
| Reconciling items: | | | |
| Realized investment gains (losses), net, and related adjustments(1) | 619 | (602 ) | 989 |
| Charges related to realized investment gains (losses), net(2) | (316 ) | 544 | (466 ) |
| Investment gains (losses) on assets supporting experience-rated contractholder liabilities, net(3) | (863 ) | 336 | (17 ) |
| Change in experience-rated contractholder liabilities due to asset value changes(4) | 710 | (151 ) | 21 |
| Divested and Run-off Businesses(5): | | | |
| Closed Block division | (62 ) | 45 | (132 ) |
| Other Divested and Run-off Businesses | (1,535 ) | 38 | (84 ) |
| Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests(6) | (87 ) | 33 | (5 ) |
| Consolidated income (loss) before income taxes and equity in earnings of operating joint ventures | $4,834 | $6,487 | $5,705 |

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(1) Represents “Realized investment gains (losses), net,” and related adjustments. See “—General Account Investments” and Note 21 to our Consolidated Financial Statements for additional information.

(2) Includes charges that represent the impact of realized investment gains (losses), net, on the amortization of DAC and other costs, and on changes in reserves. Also includes 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 (“URR”).

(3) Represents net investment gains (losses) on assets supporting experience-rated contractholder liabilities. See “—Experience-Rated Contractholder Liabilities, Assets Supporting Experience-Rated Contractholder Liabilities and Other Related Investments.”

(4) Represents changes in contractholder liabilities due to asset value changes in the pool of investments supporting these experience-rated contracts. See “—Experience-Rated Contractholder Liabilities, Assets Supporting Experience-Rated Contractholder Liabilities and Other Related Investments.”

(5) Represents the contribution to income (loss) of Divested and Run-off 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. See “—Divested and Run-off Businesses.”

(6) Equity in earnings of operating joint ventures are included in adjusted operating income but excluded from “Income (loss) before income taxes and equity in earnings of operating joint ventures” as they are reflected on an after-tax U.S. GAAP basis as a separate line in our Consolidated Statements of Operations. Earnings attributable to

noncontrolling interests are excluded from adjusted operating income but included in "Income (loss) 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 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.

Segment results for 2018 presented above reflect the following:

PGIM. Segment results for 2018 decreased in comparison to 2017, primarily reflecting lower net incentive fees and reduced strategic investing results, partially offset by higher asset management fees, net of related expenses.

Retirement. Segment results for 2018 decreased in comparison to 2017, primarily reflecting lower net investment spread results, a net unfavorable comparative impact from our annual reviews and update of assumptions and other refinements and higher general and administrative expenses, partially offset by a higher contribution from reserve experience and the impact of business growth.

Group Insurance. Segment results for 2018 decreased in comparison to 2017, reflecting higher expenses, a lower contribution from net investment spread results and less favorable comparative net impacts from our annual reviews and update of assumptions and other refinements, partially offset by more favorable underwriting results in our group life and group disability businesses.

Individual Annuities. Segment results for 2018 decreased in comparison to 2017, primarily reflecting lower net investment spread results, higher capital hedge costs and higher distribution expenses, partially offset by lower amortization costs and reserve provisions as well as higher asset-based fee income.

Individual Life. Segment results for 2018 increased in comparison to 2017, primarily reflecting favorable comparative net impacts from our annual reviews and update of assumptions and other refinements, partially offset by lower underwriting results and a lower contribution from net investment spread results.

International Insurance. Segment results for 2018 increased in comparison to 2017, inclusive of favorable net impacts from foreign currency exchange rates and comparatively unfavorable net impacts from our annual reviews and update of assumptions and other refinements. Excluding these items, the increase in segment results primarily reflected business growth, lower expenses, including lower legal costs, partially offset by a lower contribution from net investment spread results and an unfavorable impact from mortality experience.

Corporate and Other operations. Results for 2018 reflected decreased losses in comparison to 2017, driven by lower levels of corporate expenses, higher income from our qualified pension plan and lower interest expense, partially offset by lower net investment income.

Closed Block Division. Results for 2018 decreased in comparison to 2017, primarily driven by a decrease in net realized investment gains and related activity, and lower net investment income, partially offset by a favorable policyholder dividend obligation adjustment and an increase in net insurance activity.

Segment Measures

Adjusted Operating Income. In managing our business, we analyze our segments' operating performance using "adjusted operating income." Adjusted operating income does not equate to "Income (loss) before income taxes and equity in earnings of operating joint ventures" or "Net income (loss)" 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 the understanding of our results of operations by highlighting the results from ongoing operations and the underlying profitability of our businesses. See Note 21 to the Consolidated Financial Statements for further information on the presentation of segment results and our definition of adjusted operating income.

Annualized New Business Premiums. In managing our Individual Life, Group Insurance and International Insurance businesses, we analyze 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 business, 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 amount of annualized new business premiums for any given period can be significantly impacted by several factors, including but not limited to: addition of new products, discontinuation of existing products, changes in credited interest rates for certain products and other product modifications, changes in premium rates, changes in tax laws, changes in regulations or changes in the competitive environment. Sales volume may increase or decrease prior to certain of these changes becoming effective, and then fluctuate in the other direction following such changes.

Assets Under Management. In managing our PGIM business, we analyze assets under management (which do not correspond directly to U.S. GAAP assets) because the principal source of revenues is fees based on assets under management. Assets under management represents the fair market value or account value of assets which we manage directly for institutional clients, retail clients, and for our general account, as well as assets invested in our products that are managed by third-party managers.

Account Values. In managing our Individual Annuities and Retirement businesses, we analyze account values, which do not correspond to U.S. GAAP assets. Net sales (redemptions) in our Individual Annuities business and net additions (withdrawals) in our Retirement business do not correspond to revenues under U.S. GAAP, but are used as a relevant measure of business activity.

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Impact of Foreign Currency Exchange Rates

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 ("USD")-equivalent earnings and shareholder return on equity. Our USD-equivalent earnings could be materially affected by currency fluctuations from period to period, even if earnings on a local currency basis are relatively constant. Our USD-equivalent equity is impacted as the value of our investment in international operations may also fluctuate based on changes in foreign currency exchange rates. We seek to mitigate these impacts through various hedging strategies, including the use of derivative contracts and by holding USD-denominated assets in certain of our foreign subsidiaries.

In order to reduce earnings volatility from foreign currency exchange rate movements, we enter into forward currency derivative contracts to effectively fix the currency exchange rates for a portion of our prospective non-USD-denominated earnings streams. This forward currency hedging program is primarily associated with our insurance operations in Japan and Korea.

In order to reduce equity volatility from foreign currency exchange rate movements, we primarily utilize a yen hedging strategy that calibrates the hedge level to preserve the relative contribution of our yen-based business to the Company's overall return on equity on a leverage neutral basis. We implement this hedging strategy utilizing a variety of instruments, including USD-denominated assets, foreign currency derivative contracts, and dual currency and synthetic dual currency investments held locally in our Japanese insurance subsidiaries. The total hedge level may vary based on our periodic assessment of the relative contribution of our yen-based business to the Company's overall return on equity.

The table below presents the aggregate amount of instruments that serve to hedge the impact of foreign currency exchange movements on our USD-equivalent shareholder return on equity from our Japanese insurance subsidiaries as of the dates indicated.

| | December 31, | |
|---|---|---|
| | 2018 | 2017 |
| | (in billions) | |
| Foreign currency hedging instruments: | | |
| Hedging USD-equivalent earnings: | | |
| Forward currency contracts (notional amount outstanding) | $ 1.3 | $ 1.6 |
| Hedging USD-equivalent equity: | | |
| USD-denominated assets held in yen-based entities(1) | 13.5 | 13.8 |
| Dual currency and synthetic dual currency investments(2) | 0.6 | 0.6 |
| Total USD-equivalent equity foreign currency hedging instruments | 14.1 | 14.4 |
| Total foreign currency hedges | $ 15.4 | $ 16.0 |

(1) Includes USD-denominated fixed maturities at amortized cost plus any related accrued investment income, as well as USD notional amount of foreign currency derivative contracts outstanding. Note this amount represents only those USD assets serving to hedge the impact of foreign currency volatility on equity. Separate from this program, our Japanese operations also have $48.9 billion and $41.2 billion as of December 31, 2018 and 2017, respectively, of USD-denominated assets supporting USD-denominated liabilities related to USD-denominated products.
(2) Dual currency and synthetic dual currency investments are held by our yen-based entities in the form of fixed maturities and loans with a yen-denominated principal component and USD-denominated interest income. The

amounts shown represent the present value of future USD-denominated cash flows.

The USD-denominated investments that hedge the impact of foreign currency exchange rate movements on USD-equivalent earnings and shareholder return on equity from our Japanese insurance operations are reported within yen-based entities and, as a result, foreign currency exchange rate movements will impact their value reported within our yen-based Japanese insurance entities. We seek to mitigate the risk that future unfavorable foreign currency exchange rate movements will decrease the value of these USD-denominated investments reported within our yen-based Japanese insurance entities, and therefore negatively impact their equity and regulatory solvency margins, by having our Japanese insurance operations enter into currency hedging transactions. Those hedges are with a subsidiary of Prudential Financial. These hedging strategies have the economic effect of moving the change in value of these USD-denominated investments due to foreign currency exchange rate movements from our Japanese yen-based entities to our USD-based entities.

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These USD-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 USD-denominated investments, as well as our dual currency and synthetic dual currency investments, will vary over time, and is dependent on the duration of the underlying investments as well as interest rate environments in both the U.S. and Japan at the time of the investments.

Impact of foreign currency exchange rate movements on segment results of operations

The financial results of our International Insurance and PGIM segments reflect the impact of intercompany arrangements with our Corporate and Other operations pursuant to which certain of these segments' non-USD earnings are translated at fixed currency exchange rates. The financial results of our Retirement segment reflected the impact of an intercompany foreign currency exchange arrangement with our Corporate and Other operations in 2016 and 2017 prior to its termination effective January 1, 2018. This foreign currency exchange risk is now managed within our Retirement segment using a strategy that may include external hedges. Results of our Corporate and Other operations include any differences between the translation adjustments recorded by the segments at the fixed currency exchange rate versus the actual average rate during the period. In addition, specific to our International Insurance segment where we hedge certain currencies, the results of our Corporate and Other operations also include the impact of any 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.

For International Insurance, the fixed currency exchange rates are generally determined in connection with a foreign currency income hedging program designed to mitigate the impact of exchange rate changes on the segment's USD-equivalent earnings. Pursuant to this program, our Corporate and Other operations execute forward currency contracts with third parties to sell the net exposure of projected earnings for certain currencies in exchange for USD at specified exchange rates. The maturities of these contracts correspond with the future periods (typically on a three-year rolling basis) in which the identified non-USD-denominated earnings are expected to be generated. In establishing the level of non-USD-denominated earnings that will be hedged through this program, we exclude the anticipated level of USD-denominated earnings that will be generated by USD-denominated products and investments. For the twelve months ended December 31, 2018, approximately 18% of the segment's earnings were yen-based and, as of December 31, 2018, we have hedged 100%, 72% and 28% of expected yen-based earnings for 2019, 2020 and 2021, respectively. To the extent currently unhedged, our International Insurance segment's future expected USD-equivalent of yen-based earnings will be impacted by yen exchange rate movements.

As a result of these arrangements, our International Insurance segment's results for 2018, 2017 and 2016 reflect the impact of translating yen-denominated earnings at fixed currency exchange rates of 111, 112, 106 yen per U.S. dollar, respectively, and Korean won-denominated earnings at fixed currency exchange rates of 1150, 1130, and 1100 Korean won per U.S. dollar, respectively. We expect our 2019 results to reflect the impact of translating yen-denominated earnings at a fixed currency exchange rate of 105 yen per U.S. dollar and Korean won-denominated earnings at a fixed currency exchange rate of 1110 won per U.S. dollar. Since determination of the fixed currency exchange rates for a given year is impacted by changes in foreign currency exchange rates over time, the segment's future earnings will ultimately be impacted by these changes in exchange rates. For PGIM and certain other currencies within International Insurance, the fixed currency exchange rates for the current year are predetermined during the third quarter of the prior year using forward currency exchange rates.

The table below presents, for the periods indicated, the increase (decrease) to revenues and adjusted operating income for the International Insurance, PGIM and Retirement segments and for Corporate and Other operations, reflecting the impact of these intercompany arrangements.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | (in millions) | | |
| Segment impacts of intercompany arrangements: | | | |
| International Insurance | $10 | $3 | $23 |
| PGIM | 0 | 0 | 6 |
| Retirement(1) | 0 | 2 | 9 |
| Impact of intercompany arrangements(2) | 10 | 5 | 38 |
| Corporate and Other operations: | | | |
| Impact of intercompany arrangements(2) | (10 ) | (5 ) | (38 ) |
| Settlement gains (losses) on forward currency contracts(3) | (13 ) | (16 ) | 38 |
| Net benefit (detriment) to Corporate and Other operations | (23 ) | (21 ) | 0 |
| Net impact on consolidated revenues and adjusted operating income | $(13) | $(16) | $38 |

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(1) Effective January 1, 2018 the intercompany arrangement between our Corporate and Other operations and Retirement was terminated and this risk is now managed within our Retirement segment using a strategy that may include external hedges.
(2) Represents the difference between non-USD-denominated earnings translated on the basis of weighted average monthly currency exchange rates versus fixed currency exchange rates determined in connection with the foreign currency income hedging program.
(3) As of December 31, 2018, 2017 and 2016, the notional amounts of these forward currency contracts within our Corporate and Other operations were $2.6 billion, $2.8 billion and $2.7 billion, respectively, of which $1.3 billion, $1.5 billion and $1.6 billion, respectively, were related to our Japanese insurance operations.

Impact of products denominated in non-local currencies on U.S. GAAP earnings

While our international insurance operations offer products denominated in local currency, several also offer products denominated in non-local currencies, most notably our Japanese operations, which offer USD- and Australian dollar (“AUD”)-denominated products. The non-local currency-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 the impact from foreign currency exchange rate movements on these non-local currency-denominated assets and liabilities is economically matched, differences in the accounting for changes in the value of these assets and liabilities due to changes in foreign currency exchange rate movements have historically resulted in volatility in U.S. GAAP earnings.

In the first quarter of 2015 we implemented a structure in Gibraltar Life’s operations that disaggregated the USD- and AUD-denominated businesses into separate divisions, each with its own functional currency that aligns with the underlying products and investments. The result of this alignment was to reduce differences in the accounting for changes in the value of these assets and liabilities that arise due to changes in foreign currency exchange rate movements. For the USD- and AUD-denominated assets that were transferred under this structure, the net cumulative unrealized investment gains associated with foreign exchange remeasurement that were recorded in “Accumulated other comprehensive income (loss)” (“AOCI”) totaled $6.0 billion and will be recognized in earnings within “Realized investment gains (losses), net” over time as these assets mature or are sold. As of December 31, 2018, the remaining net cumulative unrealized investment gains balance related to these assets was $3.2 billion. Absent the sale of any of these assets prior to their stated maturity, approximately 9% of the $3.2 billion balance will be recognized in 2019, approximately 12% will be recognized in 2020, and a majority of the remaining balance will be recognized from 2021 through 2024.

Highly inflationary economy in Argentina

Our insurance operations in Argentina, Prudential of Argentina (“POA”), have historically utilized the Argentine peso as the functional currency given it is the currency of the primary economic environment in which the entity operates. During 2018, Argentina experienced a cumulative inflation rate that exceeded 100% over a 3-year period. As a result, Argentina’s economy was deemed to be highly inflationary resulting in reporting changes effective July 1, 2018. Under U.S. GAAP, the financial statements of a foreign entity in a highly inflationary economy are to be remeasured as if its functional currency (formerly the Argentine peso) is the reporting currency of its parent reporting entity (the USD) on a prospective basis. While this changed how the results of POA are remeasured and/or translated into the USD, the impact to our financial statements was not material nor is it expected to be material in future periods given the relative size of our POA operations. It should also be noted that due to the macroeconomic environment in Argentina, POA’s sales are predominantly denominated in USD and therefore substantially all of POA’s balance sheet consists of USD-denominated product liabilities supported by USD-denominated assets. As a result, this accounting change serves to reduce the remeasurement impact reflected in net income given that the functional currency and currency in which the assets and liabilities are denominated will be more closely aligned.

Accounting Policies & Pronouncements

Application of Critical Accounting Estimates

The preparation of financial statements in conformity with 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, the Company's results of operations and financial position as reported in the Consolidated Financial Statements could change significantly.

The following sections discuss the accounting policies applied in preparing our financial statements that management believes are most dependent on the application of estimates and assumptions and require management's most difficult, subjective, or complex judgments.

Insurance Assets

Deferred Policy Acquisition Costs and Deferred Sales Inducements



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We capitalize costs that are directly related to the acquisition or renewal of insurance and annuity contracts. These costs primarily include commissions, as well as costs of policy issuance and underwriting and certain other expenses that are directly related to successfully negotiated contracts. We have also deferred costs associated with sales inducements related to our variable and fixed annuity contracts primarily within our Individual Annuities segment. Sales inducements are amounts that are credited to the policyholders' account balances mainly as an inducement to purchase the contract. For additional information about sales inducements, see Note 12 to the Consolidated Financial Statements. We generally amortize DAC and deferred sales inducements ("DSI") over the expected lives of the contracts, based on our estimates of the level and timing of gross premiums, gross profits, or gross margins, depending on the type of contract. As described in more detail below, in calculating DAC and DSI amortization, we are required to make assumptions about investment returns, mortality, persistency, and other items that impact our estimates of the level and timing of gross margins, gross profits, or gross premiums. We also periodically evaluate the recoverability of our DAC and DSI. For certain contracts, this evaluation is performed as part of our premium deficiency testing, as discussed further below in "—Insurance Liabilities—Future Policy Benefits." As of December 31, 2018, DAC and DSI for PFI excluding the Closed Block division were $19.8 billion and $1.0 billion, respectively, and DAC in our Closed Block division was $264 million.

Amortization methodologies

Gross Premiums. DAC associated with the non-participating term life policies of our Individual Life segment and the whole life, term life, endowment and health policies of our International Insurance segment is primarily amortized in proportion to gross premiums. Gross premiums are defined as the premiums charged to a policyholder for an insurance contract.

Gross Profits. DAC and DSI associated with the variable and universal life policies of our Individual Life and International Insurance segments and the variable and fixed annuity contracts of our Individual Annuities and International Insurance segments are generally amortized over the expected lives of these policies in proportion to total gross profits. Total gross profits include both actual gross profits and estimates of gross profits for future periods. Gross profits are defined as i) amounts assessed for mortality, contract administration, surrender charges, and other assessments plus amounts earned from investment of policyholder balances less ii) benefit claims in excess of policyholder balances, costs incurred for contract administration, the net cost of reinsurance for certain businesses, interest credited to policyholder balances and other credits. If significant negative gross profits are expected in any periods, the amount of insurance in force is generally substituted as the base for computing amortization. For variable annuities in our Individual Annuities segment, U.S. GAAP gross profits and amortization rates also include the impacts of the embedded derivatives associated with certain of the optional living benefit features of our variable annuity contracts and related hedging activities. For additional information on the significant inputs to the valuation models for these embedded derivatives including capital market assumptions and actuarially determined assumptions, see below "—Insurance Liabilities—Future Policy Benefits." In calculating amortization expense, we estimate the amounts of gross profits that will be included in our U.S. GAAP results and in adjusted operating income, and utilize these estimates to calculate distinct amortization rates and expense amounts. We also regularly evaluate and adjust the related DAC and DSI balances with a corresponding charge or credit to current period earnings for the impact of actual gross profits and changes in our projections of estimated future gross profits on our DAC and DSI amortization rates. Adjustments to the DAC and DSI balances include the impact to our estimate of total gross profits of the annual review of assumptions, our quarterly adjustments for current period experience, and our quarterly adjustments for market performance. Each of these adjustments is further discussed below in "—Annual assumptions review and quarterly adjustments."

Gross Margins. DAC associated with the traditional participating products of our Closed Block is amortized over the expected lives of those contracts in proportion to estimated gross margins. Gross margins are defined as: i) amounts

received from premiums, earned from investment of policyholder balances and other assessments, less ii) benefits claims paid, costs for contract administration, changes in the net level premium reserve for death and endowment benefits, annual policyholder dividends and other credits. We evaluate our estimates of future gross margins and adjust the related DAC balance with a corresponding charge or credit to current period earnings for the effects of actual gross margins and changes in our expected future gross margins. DAC adjustments for these participating products generally have not created significant volatility in our results of operations since many of the factors that affect gross margins are also included in the determination of our dividends to these policyholders and, during most years, the Closed Block has recognized a cumulative policyholder dividend obligation expense in “Policyholders’ dividends,” for the excess of actual cumulative earnings over expected cumulative earnings as determined at the time of demutualization. However, if actual cumulative earnings fall below expected cumulative earnings in future periods, thereby eliminating the cumulative policyholder dividend obligation expense, changes in gross margins and DAC amortization would result in a net impact to the Closed Block results of operations. As of December 31, 2018, the excess of actual cumulative earnings over the expected cumulative earnings was $2,252 million.

The amortization methodologies for products not discussed above primarily relate to less significant DAC and DSI balances associated with products in our Group Insurance and Retirement segments, which comprised approximately 2% of the Company’s total DAC and DSI balances as of December 31, 2018.

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Annual assumptions review and quarterly adjustments

Annually, we perform a comprehensive review of the assumptions used in estimating gross profits for future periods. Over the last several years, the Company's most significant assumption updates resulting in a change to expected future gross profits and the amortization of DAC and DSI have been related to lapse and other contractholder behavior assumptions, mortality, and revisions to expected future rates of returns on investments. These assumptions may also cause potential significant variability in amortization expense in the future. The impact on our results of operations of changes in these assumptions can be offsetting and we are unable to predict their movement or offsetting impact over time.

The quarterly adjustments for current period experience referred to above reflect the impact of differences between actual gross profits for a given period and the previously estimated expected gross profits for that period. To the extent each period's actual experience differs from the previous estimate for that period, the assumed level of total gross profits may change. In these cases, we recognize a cumulative adjustment to all previous periods' amortization, also referred to as an experience true-up adjustment.

The quarterly adjustments for market performance referred to above reflect the impact of changes to our estimate of total gross profits to reflect actual fund performance and market conditions. A significant portion of gross profits for our variable annuity contracts and, to a lesser degree, our variable life policies are dependent upon the total rate of return on assets held in separate account investment options. This rate of return influences the fees we earn on variable annuity and variable life policies, costs we incur associated with the guaranteed minimum death and guaranteed minimum income benefit features related to our variable annuity contracts and expected claims to be paid on variable life contracts, as well as other sources of profit. Returns that are higher than our expectations for a given period produce higher than expected account balances, which increase the future fees we expect to earn on variable annuity and variable life policies and decrease the future costs we expect to incur associated with the guaranteed minimum death and guaranteed minimum income benefit features related to our variable annuity contracts and expected claims to be paid on variable life contracts. The opposite occurs when returns are lower than our expectations. The changes in future expected gross profits are used to recognize a cumulative adjustment to all prior periods' amortization.

The near-term future equity rate of return assumption used in evaluating DAC and other costs for our domestic variable annuity and variable life insurance products is derived using a reversion to the mean approach, a common industry practice. Under this approach, we consider historical equity returns and adjust projected equity returns over an initial future period of five years (the "near-term") so that equity returns converge to the long-term expected rate of return. If the near-term projected future rate of return is greater than our near-term maximum future rate of return of 15.0%, we use our maximum future rate of return. As of December 31, 2018, our variable annuities and variable life insurance businesses assume an 8.0% long-term equity expected rate of return and a 7.6% near-term mean reversion equity expected rate of return.

The weighted average rate of return assumptions consider many factors specific to each business, including asset durations, asset allocations and other factors. We generally update the near-term equity rates of return and our estimate of total gross profits each quarter to reflect the result of the reversion to the mean approach. We generally update the future interest rates used to project fixed income returns annually and in any quarter when interest rates vary significantly from these assumptions. As a result of our 2018 annual reviews and update of assumptions and other refinements, we kept our long-term expectation of the 10-year U.S. Treasury rate unchanged from last year and continue to grade to 3.75% over ten years. In Japan, we reduced the long-term expected return on 10-year Japanese Government Bonds by 20 basis points and now grade to 1.30% over ten years.

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.

Value of Business Acquired

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In addition to DAC and DSI, we also recognize an asset for VOBA. VOBA is an intangible asset which represents an adjustment to the stated value of acquired in-force insurance contract liabilities to present them at fair value, determined as of the acquisition date. VOBA is amortized over the expected life of the acquired contracts using the same methodology and assumptions used to amortize DAC and DSI (see "—Deferred Policy Acquisition Costs and Deferred Sales Inducements" above for additional information). VOBA is also subject to recoverability testing. As of December 31, 2018, VOBA was $1.9 billion, and included $1.1 billion related to the acquisition from American International Group ("AIG") of AIG Star Life Insurance Co., Ltd, AIG Edison Life Insurance Company, AIG Financial Assurance Japan K.K. and AIG Edison Service Co., Ltd. (collectively, the "Star and Edison Businesses") in 2011, and $0.5 billion related to the acquisition of The Hartford Financial Services Group's individual life insurance business in 2013. The remaining $0.3 billion primarily relates to previously-acquired traditional life, deferred annuity, defined contribution and defined benefit businesses. The VOBA associated with the in-force contracts of the Star and Edison Businesses is less sensitive to assumption changes, as the majority is amortized in proportion to gross premiums which are more predictably stable compared to gross profits.

Insurance Liabilities

Future Policy Benefits

Future Policy Benefit Reserves, including Unpaid Claims and Claim Adjustment Expenses

We establish reserves for future policy benefits to, or on behalf of, policyholders using methodologies prescribed by U.S. GAAP. The reserving methodologies used include the following:

- For most long-duration contracts, we utilize a net premium valuation methodology in measuring the liability for future policy benefits. Under this methodology, a liability for future policy benefits is accrued when premium revenue is recognized. The liability, which represents the present value of future benefits to be paid to or on behalf of policyholders and related expenses less the present value of future net premiums (portion of the gross premium required to provide for all benefits and expenses), is estimated using methods that include assumptions applicable at the time the insurance contracts are made with provisions for the risk of adverse deviation, as appropriate. Original assumptions continue to be used in subsequent accounting periods to determine changes in the liability for future policy benefits (often referred to as the "lock-in concept") unless a premium deficiency exists. The result of the net premium valuation methodology is that the liability at any point in time represents an accumulation of the portion of premiums received to date expected to be needed to fund future benefits (i.e., net premiums received to date), less any benefits and expenses already paid. The liability does not necessarily reflect the full policyholder obligation the Company expects to pay at the conclusion of the contract since a portion of that obligation would be funded by net premiums received in the future and would be recognized in the liability at that time. We perform premium deficiency tests using best estimate assumptions as of the testing date without provisions for adverse deviation. If the liabilities determined based on these best estimate assumptions are greater than the net reserves (i.e., GAAP reserves net of any DAC, DSI or VOBA asset), the existing net reserves are adjusted by first reducing these assets by the amount of the deficiency or to zero through a charge to current period earnings. If the deficiency is more than these asset balances for insurance contracts, we then increase the net reserves by the excess, again through a charge to current period earnings. If a premium deficiency is recognized, the assumptions as of the premium deficiency test date are locked in and used in subsequent valuations and the net reserves continue to be subject to premium deficiency testing. In addition, for limited-payment contracts, future policy benefit reserves also include a deferred profit liability representing gross premiums received in excess of net premiums. The deferred profits are generally recognized in revenue in a constant relationship with insurance in force or with the amount of expected future benefit payments.
- For certain contract features, such as those related to guaranteed minimum death benefits ("GMDB"), guaranteed minimum income benefits ("GMIB") and no-lapse guarantees, a liability is established when associated assessments (which include all policy charges including charges for administration, mortality, expense, surrender, and other.

regardless of how characterized) are recognized. This liability is established using current best estimate assumptions and is based on the ratio of the present value of total expected excess payments (i.e., payments in excess of account value) over the life of the contract divided by the present value of total expected assessments (i.e., benefit ratio). The liability equals the current benefit ratio multiplied by cumulative assessments recognized to date, plus interest, less cumulative excess payments to date. Similar to as described above for DAC, the reserves are subject to adjustments based on annual reviews of assumptions and quarterly adjustments for experience, including market performance. These adjustments reflect the impact on the benefit ratio of using actual historical experience from the issuance date to the balance sheet date plus updated estimates of future experience. The updated benefit ratio is then applied to all prior periods' assessments to derive an adjustment to the reserve recognized through a benefit or charge to current period earnings.

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For certain product guarantees, primarily certain optional living benefit features of the variable annuity products in our Individual Annuities segment including guaranteed minimum accumulation benefits ("GMAB"), guaranteed minimum withdrawal benefits ("GMWB") and guaranteed minimum income and withdrawal benefits ("GMIWB"), the benefits are accounted for as embedded derivatives using a fair value accounting framework. The fair value of these contracts is calculated as the present value of expected future benefit payments to contractholders less the present value of assessed rider fees attributable to the embedded derivative feature. Under U.S. GAAP, the fair values of these benefit features are based on assumptions a market participant would use in valuing these embedded derivatives. Changes in the fair value of the embedded derivatives are recorded quarterly through a benefit or charge to current period earnings.

The assumptions used in establishing reserves are generally based on the Company's experience, industry experience and/or other factors, as applicable. We typically update our actuarial assumptions, such as mortality, morbidity, retirement and policyholder behavior assumptions, annually, unless a material change is observed in an interim period that we feel is indicative of a long-term trend. Generally, we do not expect trends to change significantly in the short-term and, to the extent these trends may change, we expect such changes to be gradual over the long-term. In a sustained low interest rate environment, there is an increased likelihood that the reserves determined based on best estimate assumptions may be greater than the net liabilities.

The following paragraphs provide additional details about the reserves established by each of our segments:

International Insurance. The reserves for future policy benefits of our International Insurance segment, which as of December 31, 2018, represented 45% of our total future policy benefit reserves, primarily relate to non-participating whole life and term life products and endowment contracts, and are generally calculated using the net premium valuation methodology, as described above. The primary assumptions used in determining expected future benefits and expenses include mortality, lapse, morbidity, investment yield and maintenance expense assumptions. Reserves also include claims reported but not yet paid, and claims incurred but not yet reported. In addition, future policy benefit reserves for certain contracts also include amounts related to our deferred profit liability, as described above.

Retirement. The reserves for future policy benefits of our Retirement segment, which as of December 31, 2018, represented 23% of our total future policy benefit reserves, primarily relate to our non-participating life contingent group annuity and structured settlement products and are generally calculated using the net premium valuation methodology, as described above. The primary assumptions used in establishing these reserves include mortality, retirement, maintenance expense and investment yield assumptions. In addition, future policy benefit reserves for certain contracts also include amounts related to our deferred profit liability, as described above.

Individual Annuities. The reserves for future policy benefits of our Individual Annuities segment, which as of December 31, 2018, represented 4% of our total future policy benefit reserves, primarily relate to reserves for the GMDB and GMIB features of our variable annuities, and for the optional living benefit features that are accounted for as embedded derivatives. As discussed above, in establishing reserves for GMDBs and GMIBs, we utilize current best estimate assumptions. The primary assumptions used in establishing these reserves generally include annuitization, lapse, withdrawal and mortality assumptions, as well as interest rate and equity market return assumptions. Lapse rates are adjusted at the contract level based on the in-the-moneyness of the living benefit and reflect other factors, such as the applicability of any surrender charges. Lapse rates are reduced when contracts are more in-the-money. Lapse rates are also generally assumed to be lower for the period where surrender charges apply. For life contingent payout annuity contracts, we establish reserves using best estimate assumptions with provisions for adverse deviations as of inception or best estimate assumptions as of the most recent loss recognition event.

The reserves for certain optional living benefit features, including GMAB, GMWB and GMIWB are accounted for as embedded derivatives at fair value, as described above. This methodology could result in either a liability or

contra-liability balance, given changing capital market conditions and various actuarial 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 significant inputs to the valuation models for these embedded derivatives include capital market assumptions, such as interest rate levels and volatility assumptions, the Company's market-perceived risk of its own non-performance risk ("NPR"), as well as actuarially determined assumptions, including mortality rates and contractholder behavior, such as lapse rates, benefit utilization rates and withdrawal rates. Capital market inputs and actual contractholders' account values are updated each quarter based on capital market conditions as of the end of the quarter, including interest rates, equity markets and volatility. In the risk neutral valuation, the initial swap curve drives the total returns used to grow the contractholders' account values. The Company's discount rate assumption is based on the London Inter-Bank Offered Rate swap curve adjusted for an additional spread, which includes an estimate of NPR. Actuarial assumptions, including contractholder behavior and mortality, are reviewed at least annually, and updated based upon emerging experience, future expectations and other data, including any observable market data, such as available industry studies or market transactions

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such as acquisitions and reinsurance transactions. For additional information regarding the valuation of these optional living benefit features, see Note 6 to the Consolidated Financial Statements.

Individual Life. The reserves for future policy benefits of our Individual Life segment, which as of December 31, 2018, represented 5% of our total future policy benefit reserves, primarily relate to term life, universal life and variable life products. For term life contracts, the future policy benefit reserves are generally calculated using the net premium valuation methodology, as described above. The primary assumptions used in determining expected future benefits and expenses include mortality, lapse, investment yield and maintenance expense assumptions. For variable and universal life products, which include universal life contracts that contain no-lapse guarantees, reserves for future policy benefits are primarily established using the reserving methodology for GMDB and GMIB contracts. As discussed above, in establishing reserves for GMDBs and GMIBs, we utilize current best estimate assumptions. The primary assumptions used in establishing these reserves generally include mortality, lapse, and premium pattern, as well as interest rate and equity market return assumptions. Reserves also include claims reported but not yet paid, and claims incurred but not yet reported.

Group Insurance. The reserves for future policy benefits of our Group Insurance segment, which as of December 31, 2018, represented 2% of our total future policy benefit reserves, primarily relate to reserves for group life and disability benefits. For short-duration contracts, a liability is established when the claim is incurred. The reserves for group life and disability benefits include our liability of $2.6 billion for unpaid claims and claim adjustment expenses for our Group Insurance segment as of December 31, 2018, which relates primarily to the group long-term disability product. This liability represents our estimate of future disability claim payments and expenses as well as estimates of claims that have been incurred, but have not yet been reported, as of the balance sheet date. The liability is determined as the present value of expected future claim payments and expenses. The primary assumptions used in determining expected future claim payments are claim termination factors, an assumed interest rate and expected Social Security offsets. The remaining reserves for future policy benefits for group life and disability benefits relate primarily to our group life business, and include reserves for Waiver of Premium, Claims In Course of Settlement and Claims Incurred But Not Reported. The Waiver of Premium reserve is calculated as the present value of future benefits and utilizes assumptions such as expected mortality and recovery rates. The Claims In Course of Settlement reserve is based on the inventory of claims that have been reported but not yet paid. The Claims Incurred But Not Reported reserve is estimated using expected patterns of claims reporting.

Corporate and Other operations. The reserves for future policy benefits of our Corporate & Other operations, which as of December 31, 2018, represented 3% of our total future policy benefit reserves, primarily relate to our long-term care products and are generally calculated using the net premium valuation methodology, as described above. Most contracts have recorded a premium deficiency reserve, for which we use assumptions as of the most recent premium deficiency reserve establishment. The primary assumptions used in establishing these reserves include interest rate, morbidity, mortality, lapse, premium rate increase and maintenance expense assumptions. In addition, certain less significant reserves for our long-term care products, such as our disabled life reserves, are established using current best estimate actuarial assumptions.

Closed Block Division. The future policy benefit reserves for the traditional participating life insurance products of the Closed Block division, which as of December 31, 2018, represented 18% of our total future policy benefit reserves are determined using the net premium valuation methodology, as described above. Under this method, the future policy benefit reserves are accrued as a level proportion of the premium paid by the policyholder. In applying this method, we use mortality assumptions to determine our expected future benefits and expected future premiums, and apply an interest rate to determine the present value of both of these amounts. The mortality assumptions are based on standard industry mortality tables that were used to determine the cash surrender value of the policies, and the interest rates used are the interest rates used to calculate the cash surrender value of the policies.

Profits Followed by Losses

In certain instances, the policyholder liability for a particular line of business may not be deficient in the aggregate to trigger loss recognition, but the pattern of earnings may be such that profits are expected to be recognized in earlier years followed by losses in later years. In these situations, accounting standards require that an additional liability (Profits Followed by Losses or "PFL" liability) be recognized by an amount necessary to sufficiently offset the losses that would be recognized in later years. The PFL liability is based on our current estimate of the present value of the amount necessary to offset losses anticipated in future periods. Because the liability is measured on a discounted basis, there will also be accretion into future earnings through an interest charge, and the liability will ultimately be released into earnings as an offset to future losses. Historically, the Company's PFL liability has been predominantly associated with certain universal life contracts that measure net GAAP reserves using current best estimate assumptions and accordingly, has been updated each quarter using current in-force and market data and as part of the annual assumption update. At the target accrual date (i.e., date of peak deficiency), the PFL liability transitions to a premium deficiency reserve and, for universal life products, will continue to be updated each quarter using current in-force and market data and as part of the annual assumption update.

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Policyholders' Account Balances

Unearned Revenue Reserve

Policyholders' account balances liability represents the contract value that has accrued to the benefit of the policyholder as of the balance sheet date. This liability is primarily associated with the accumulated account deposits, plus interest credited, less policyholder withdrawals and other charges assessed against the account balance, as applicable. Our URR, also reported as a component of "Policyholders' account balances," was $3.4 billion as of December 31, 2018. This reserve primarily relates to variable and universal life products within our Individual Life and International Insurance segments and represents policy charges for services to be provided in future periods. The charges are deferred as unearned revenue and are generally amortized over the expected life of the contract in proportion to the product's estimated gross profits, similar to DAC and DSI as discussed above.

Sensitivities for Insurance Assets and Liabilities

The following table summarizes the impact that could result on each of the listed financial statement balances for the specified segments from changes in certain assumptions that may be considered reasonably likely to occur. The information below is for illustrative purposes and includes only the hypothetical direct impact on December 31, 2018 balances of changes in a single assumption and not changes in any combination of assumptions. The figures below are presented in aggregate for those segments that are expected to experience a significant impact as a result of the corresponding assumption change. Changes in excess of the amounts illustrated may occur in future periods. A description of the estimates and assumptions used in the preparation of each of these financial statement balances is provided further above. For traditional long duration and limited payment contracts, U.S. GAAP requires the original assumptions used when the contracts are issued to be locked-in and that those assumptions be used in all future liability calculations as long as the resulting liabilities are adequate to provide for the future benefits and expenses (i.e., there is no premium deficiency). Therefore, these products are not reflected in the sensitivity table below unless the hypothetical change in assumption would result in an adverse impact that would cause a premium deficiency. Similarly, the impact of any favorable change in assumptions for traditional long duration and limited payment contracts is not reflected in the table below given that the current assumption is required to remain locked-in, and instead the positive impacts would be recognized into net income over the life of the policies in force.

The impacts presented within this table exclude the following:

- The impacts of our asset liability management strategy which seeks to offset the changes in the balances presented within this table and is primarily comprised of investments and derivatives. See further below for a discussion of the estimates and assumptions involved with the application of U.S. GAAP accounting policies for these instruments and "Quantitative and Qualitative Disclosures about Market Risk" for hypothetical impacts on related balances as a result of changes in certain significant assumptions.

- The impacts of our Long-Term Care business, a component of our Divested and Run-off Businesses within our Corporate and Other operations. Long-Term Care sensitivities are presented separately in the immediately following table (see "—Sensitivities for the Long-Term Care business within our Corporate and Other operations"). While the accounting for long-term care products typically follows the locked-in assumptions model described above, as a result of our 2018 annual review and update of assumptions this business recognized a premium deficiency and unlocked and updated the assumption model to use a current set of best estimate assumptions. Given this unique fact pattern for this business, sensitivities are presented separately in order to provide stand-alone and supplementary information.

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| | December 31, 2018 | | |
|---|---|---|---|
| | Increase (Decrease) in Deferred Policy Acquisition Costs, Deferred Sales Inducements and Value of Business Acquired | Future Policy Benefits and Policyholders' Account Balances(1) | Net Impact |
| | (in millions) | | |
| Hypothetical change in current assumptions: | | | |
| Long-term interest rate(2): | | | |
| Increase by 25 basis points | $45 | $ (50) | $95 |
| Decrease by 25 basis points | $(45) | $ 50 | $(95) |
| Long-term equity expected rate of return(3): | | | |
| Increase by 50 basis points | $180 | $ (60) | $240 |
| Decrease by 50 basis points | $(185) | $ 60 | $(245) |
| NPR credit spread(4): | | | |
| Increase by 50 basis points | $(315) | $ (1,515) | $1,200 |
| Decrease by 50 basis points | $345 | $ 1,650 | $(1,305) |
| Mortality(5): | | | |
| Increase by 1% | $(45) | $ (60) | $15 |
| Decrease by 1% | $45 | $ 65 | $(20) |
| Lapse(6): | | | |
| Increase by 10% | $(140) | $ (610) | $470 |
| Decrease by 10% | $140 | $ 630 | $(490) |

(1) Includes GMDB/GMIB reserves, embedded derivative liabilities for certain living benefit guaranteed features, reserves for products with a premium deficiency, PFL liability, and URR.
(2) Represents the impact of a parallel shift in the long-term interest rate yield curve for the Individual Life segment and the Japanese insurance operations.
(3) Represents the impact of an increase or decrease in the long-term equity expected rate of return for the Individual Annuities segment.
(4) Represents the impact of an increase or decrease in the NPR credit spread for the Individual Annuities segment.
(5) Represents the impact of an increase or decrease in mortality rates for the Individual Life and Individual Annuities segments.
(6) Represents the impact of an increase or decrease in lapse rates for the Individual Life and Individual Annuities segments.

Sensitivities for the Long-Term Care business within our Corporate and Other operations

The following table summarizes certain significant assumptions made in establishing reserves for long-term care products and the net impact that could result from changes in these assumptions should they occur. Under U.S. GAAP, reserves for long-term care products are generally calculated using the locked-in assumptions concept described above. As such, the adverse hypothetical impacts illustrated in the table below are those that would increase our best estimate reserves and, when compared to our GAAP reserves, may cause a premium deficiency that would require us to unlock our assumptions and record a charge to net income. The favorable hypothetical impacts in the table below would decrease our best estimate reserves but they would not result in an immediate decrease to our GAAP reserves (given that we would be required to leave the current assumptions locked-in) and instead the positive impacts would be recognized into net income over the life of the policies in force.

The information below is for illustrative purposes and includes the impacts of changes in a single assumption and not changes in any combination of assumptions. As a result of emerging future experience, impacts from changes in the significant assumptions in excess of the amounts illustrated may occur in future periods.

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| | December 31, 2018 | | |
|---|---|---|---|
| | Current Assumption | Assumption Change | Increase (Decrease) in Best Estimate Reserve (in millions) |
| Assumption: | | | |
| Morbidity Improvement | None | Include improvement: 1% per year for 10 years / 20 years | ($900) - ($1,400) |
| Mortality Improvement | 1% per year for 20 years | Decrease the duration of the 1% improvement per year: 10 years to none | ($300) - ($850) |
| Expected Future Claim Costs / Base Morbidity | Based on Company and industry experience. No reflection of future claim management efficiencies | Increase / decrease in expected future claim costs: +5% to -5% | $525 - ($525) |
| Average Ultimate Lapse Rate | Individual: 0.8%<br>Group: 0.6% | -10 basis points to +10 basis points | $125 - ($125) |
| Investment Rate(1) | Weighted average of 5.39% | -25 basis points to +25 basis points | $425 - ($425) |
| Future Premium Rate Increases | Approximately $1.2 billion for the rate increase program assumed in reserves(2) | Decrease / increase unapproved rate increases by: -10% to +10% | $120 - ($120) |

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(1) Investment rate reflects the expected investment yield over the life of the block of business, and is derived from the portfolio yield, current reinvestment rates and our intermediate and long-term assumption for investment yields.
(2) Includes future premium rate increases and benefit reductions in lieu of rate increases not yet approved.

Goodwill

As of December 31, 2018, our goodwill balance of $863 million is primarily reflected in the following reporting units: $455 million related to our Retirement Full Service business, $233 million related to our PGIM business, $154 million related to our Gibraltar Life and Other operations and $11 million related to our Life Planner operations.

We test goodwill for impairment on an annual basis, as of December 31 of each year, or more frequently if events or circumstances indicate the potential for impairment is more likely than not. The goodwill impairment analysis is performed at the reporting unit level which is equal to or one level below our operating segments. Although accounting guidance provides for an optional qualitative assessment for testing goodwill impairment, all four reporting units elected to perform the quantitative two step test. For additional information on goodwill and the process for testing goodwill for impairment, see Note 2 and Note 10 to the Consolidated Financial Statements.

The Life Planner operations, the Gibraltar Life and Other operations, and the PGIM segment completed a quantitative impairment analysis using an earnings multiple approach. The earnings multiple approach indicates the value of a business based on comparison to publicly-traded comparable companies in similar lines of business. Each comparable company is analyzed based on various factors, including, but not limited to, financial risk, size, geographic diversification, profitability, adequate financial data, and an actively traded stock price. A multiple of price to earnings is developed for the comparable companies using independent analysts' consensus estimates for each company's 2019 forecasted earnings. The multiples are then aggregated and a mean and median multiple is calculated for the group.

The lower of the mean or median multiple is then applied to the 2019 forecasted earnings of the reporting unit to develop a value. A control premium is then added to determine a total estimated fair value for the reporting unit.

In the Retirement Full Service business, the quantitative impairment analysis was completed using a discounted cash flow approach. This approach calculates the value of a business by applying a discount rate reflecting the market expected rate of return of the reporting unit to its projected future cash flows. These projected future cash flows were based on our internal forecasts, an expected growth rate and a terminal value. The reporting unit expected rate of return represents the required rate of return on its total capitalization. The process of deriving reporting unit specific required rates of return begins with the calculation of an overall Company Weighted Average Cost of Capital, which includes the calculation of the required return on equity using a Capital Asset Pricing Model ("CAPM"). The CAPM is a generally accepted method for estimating an equity investor's return requirement, and hence a company's cost of equity capital. The calculation using the CAPM begins with the long-term risk-free rate of return, then applies a market risk premium for large company common stock, as well as company specific adjustments to address volatility versus the market. The Company then determines reporting unit specific required rates of return based on their relative volatilities, benchmarks results against reporting unit comparable companies, and ensures that the sum of the reporting unit required returns (after considering the impact of unallocated Corporate costs and capital) add up to the overall Company required return. This process results in reporting unit specific discount rates which are then applied to the expected future cash flows of the Retirement Full Service business to estimate fair value.

After completion of the first step of the quantitative tests, the fair values exceeded the carrying amounts for each of the four reporting units and we concluded there was no impairment as of December 31, 2018. PGIM, Life Planner operations, Gibraltar Life and Other operations, and Retirement Full Service had estimated fair values that exceeded their carrying amounts by a weighted average of 231%. Completion of the second step of the quantitative analysis is therefore not necessary.

Estimating the fair value of reporting units is a subjective process that involves the use of significant estimates by management. For all reporting units tested, market declines or other events impacting the fair value of these businesses, including discount rates, interest rates and growth rate assumptions or increases in the level of equity required to support these businesses, could result in goodwill impairments, resulting in a charge to income.

Valuation of Investments, Including Derivatives, and the Recognition of Other-than-Temporary Impairments

Our investment portfolio consists of public and private fixed maturity securities, commercial mortgage and other loans, equity securities, other invested assets, and derivative financial instruments. Derivatives are financial instruments whose values are derived from interest rates, foreign exchange rates, financial indices or the values of securities or commodities. Derivative financial instruments we generally use include swaps, futures, forwards and options and may be exchange-traded or contracted in the over-the-counter ("OTC") market. We are also party to financial instruments that contain derivative instruments that are "embedded" in the financial instruments. Management believes the following accounting policies related to investments, including derivatives, are most dependent on the application of estimates and assumptions. Each of these policies is discussed further within other relevant disclosures related to the investments and derivatives, as referenced below:

- Valuation of investments, including derivatives;
- Recognition of other-than-temporary impairments ("OTTI"); and
- Determination of the valuation allowance for losses on commercial mortgage and other loans.

We present at fair value in the statements of financial position our debt security investments classified as available-for-sale, investments classified as trading such as our assets supporting experience-rated contractholder liabilities and certain fixed maturities, equity securities, and certain investments within "Other invested assets," such as derivatives. For additional information regarding the key estimates and assumptions surrounding the determination of fair value of fixed maturity and equity securities, as well as derivative instruments, embedded derivatives and other investments, see Note 6 to the Consolidated Financial Statements and "—Valuation of Assets and Liabilities—Fair Value of

Assets and Liabilities."

For our investments classified as available-for-sale, the impact of changes in fair value is recorded as an unrealized gain or loss in AOCI, a separate component of equity. For our investments classified as trading, equity securities, and derivatives, the impact of changes in fair value is recorded within "Other income (loss)." In addition, investments classified as available-for-sale, as well as those classified as held-to-maturity, are subject to impairment reviews to identify when a decline in value is other-than-temporary. For a discussion of our policies regarding other-than-temporary declines in investment value and the related methodology for recording OTTI of fixed maturity securities, see Note 2 to the Consolidated Financial Statements.

Commercial mortgage and other loans are carried primarily at unpaid principal balances, net of unamortized deferred loan origination fees and expenses and unamortized premiums or discounts and a valuation allowance for losses. For a discussion of our policies regarding the valuation allowance for commercial mortgage and other loans, see Note 2 to the Consolidated Financial Statements.

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Pension and Other Postretirement Benefits

We sponsor pension and other postretirement benefit plans covering employees who meet specific eligibility requirements. Our net periodic costs for these plans consider an assumed discount (interest) rate, an expected rate of return on plan assets, expected increases in compensation levels, mortality and trends in health care costs. Of these assumptions, our expected rate of return assumptions and our discount rate assumptions have historically had the most significant effect on our net period costs associated with these plans.

We determine our expected rate of return on plan assets based upon a building block approach that considers inflation, real return, term premium, credit spreads, equity risk premium and capital appreciation as well as expenses, the effect of active management and the effect of rebalancing for the equity, debt and real estate asset mix applied on a weighted average basis to our pension asset portfolio. See Note 17 to our Consolidated Financial Statements for our actual asset allocations by asset category and the asset allocation ranges prescribed by our investment policy guidelines for both our pension and other postretirement benefit plans. Our assumed long-term rate of return for 2018 was 6.25% for our domestic pension plans and 7.00% for our other postretirement benefit plans. Given the amount of plan assets as of December 31, 2017, the beginning of the measurement year, if we had assumed an expected rate of return for both our domestic pension and other domestic postretirement benefit plans that was 100 bps higher or 100 bps lower than the rates we assumed, the change in our net periodic costs would have been as shown in the table below. The information provided in the table below considers only changes in our assumed long-term rate of return given the level and mix of invested assets at the beginning of the measurement year, without consideration of possible changes in any of the other assumptions described above that could ultimately accompany any changes in our assumed long-term rate of return.

| | For the year ended December 31, 2018 | |
|---|---|---|
| | Increase/(Decrease) in Net Periodic Pension Cost | Increase/(Decrease) in Net Periodic Other Postretirement Cost |
| | (in millions) | |
| Increase in expected rate of return by 100 bps | $ (128) | $ (16) |
| Decrease in expected rate of return by 100 bps | $ 128 | $ 16 |

Foreign pension plans represent 5% of plan assets at the beginning of 2018. An increase in expected rate of return by 100 bps would result in a decrease in net periodic pension costs of $6 million; conversely, a decrease in expected rate of return by 100 bps would result in an increase in net periodic pension costs of $6 million.

We determine our discount rate, used to value the pension and postretirement benefit obligations, based upon rates commensurate with current yields on high quality corporate bonds. See Note 17 to the Consolidated Financial Statements for information regarding the December 31, 2017 methodology we employed to determine our discount rate for 2018. Our assumed discount rate for 2018 was 3.65% for our domestic pension plans and 3.60% for our other domestic postretirement benefit plans. Given the amount of pension and postretirement obligations as of December 31, 2017, the beginning of the measurement year, if we had assumed a discount rate for both our domestic pension and other postretirement benefit plans that was 100 bps higher or 100 bps lower than the rates we assumed, the change in our net periodic costs would have been as shown in the table below. The information provided in the table below considers only changes in our assumed discount rate without consideration of possible changes in any of the other assumptions described above that could ultimately accompany any changes in our assumed discount rate.

| For the year ended December 31, 2018 | |
|---|---|
| Increase/(Decrease) in Net | Increase/(Decrease) in Net |

| | Periodic Pension Cost | Periodic Other Postretirement Cost |
|---|---|---|
| | (in millions) | |
| Increase in discount rate by 100 bps | $ (114 ) | $ (7 ) |
| Decrease in discount rate by 100 bps | $ 134 | $ 6 |

Foreign pension plans represent 14% of plan obligations at the beginning of 2018. An increase in discount rate by 100 bps would result in a decrease in net periodic pension costs of $17 million; conversely, a decrease in discount rate by 100 bps would result in an increase in net periodic pension costs of $2 million.

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Given the application of the authoritative guidance for accounting for pensions, and the deferral and amortization of actuarial gains and losses arising from changes in our assumed discount rate, the change in net periodic pension cost arising from an increase in the assumed discount rate by 100 bps would not always be expected to equal the change in net periodic pension cost arising from a decrease in the assumed discount rate by 100 bps.

For a discussion of our expected rate of return on plan assets and discount rate for our qualified pension plan in 2018, see "—Results of Operations by Segment—Corporate and Other."

For purposes of calculating pension income from our own qualified pension plan for the year ended December 31, 2019, we will increase the discount rate to 4.30% from 3.65% in 2018. The expected rate of return on plan assets will increase to 6.50% in 2019 from 6.25% in 2018, and the assumed rate of increase in compensation will remain unchanged at 4.5%.

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

At December 31, 2018, the sensitivity of our domestic and foreign pension and postretirement obligations to a 100 basis point change in discount rate was as follows:

| | December 31, 2018 | |
|---|---|---|
| | Increase/(Decrease) in Pension Benefits Obligation | Increase/(Decrease) in Accumulated Postretirement Benefits Obligation |
| | (in millions) | |
| Increase in discount rate by 100 bps | $ (1,333) | $ (172) |
| Decrease in discount rate by 100 bps | $ 1,515 | $ 190 |

Taxes on Income

Our effective tax rate is based on income, non-taxable and non-deductible items, tax credits, statutory tax rates and tax planning opportunities available in the various jurisdictions in which we operate. Inherent in determining our annual tax rate are judgments regarding business plans, planning opportunities and expectations about future outcomes. The Dividend Received Deduction ("DRD") is a major reason for the difference between the Company's effective tax rate and the U.S. federal statutory rate. The DRD is an estimate that incorporates the prior and current year information, as well as the current year's equity market performance. Both the current estimate of the DRD and the DRD in future periods can vary 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 underlying fund investments, changes in the account balances of variable life and annuity contracts, and the Company's taxable income before the DRD.

In December 2017, Securities and Exchange Commission ("SEC") staff issued "Staff Accounting Bulletin 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act" ("SAB 118"), which allowed the registrants to record provisional amounts during a 'measurement period' not to extend beyond one year. Under the relief provided by SAB 118, a company could recognize provisional amounts when it did not have the necessary information available, prepared or analyzed in reasonable detail to complete its accounting for the change in tax law. See Note 15 to the Consolidated Financial Statements for a discussion of provisional amounts related to The United States Tax Cuts and Jobs Act of 2017 ("Tax Act of 2017") included in "Total income tax expense (benefit) before equity in earnings of operating joint ventures" in 2017 and adjustments to provisional amounts recorded in 2018.

The Tax Act of 2017 includes a provision causing post-1986 unremitted foreign earnings of at least 10% owned non-U.S. affiliates to be included in the Company's U.S. income tax base, with an election to pay the associated tax on an eight-year installment basis. Unremitted foreign earnings from certain operations in foreign jurisdictions that impose a withholding tax on dividends are considered to be permanently reinvested for purposes of determining the applicable withholding tax expense. See Note 15 to the Consolidated Financial Statements for a discussion of unremitted earnings for which the Company provides U.S. income taxes.

An increase or decrease in our effective tax rate by one percentage point would have resulted in a decrease or increase in our 2018 "Total income tax expense (benefit)" of $48 million.

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Contingencies

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

Other Accounting Policies

Accounting for Certain Reinsurance Contracts in our Individual Life business

In 2017, we recognized a charge of $237 million in our Individual Life segment, reflecting a change in our estimate of reinsurance cash flows associated with universal life products as well as a change in our method of reflecting these cash flows in the financial statements. Under our previous method of accounting, with the exception of recoveries pertaining to no lapse guarantees, we generally recognized reinsurance cash flows (e.g., premiums and recoveries) as they occurred. Under our new method, the expected reinsurance cash flows are recognized more ratably over the life of the underlying reinsured policies. In conjunction with this change, we revised how reinsurance is reflected in estimated gross profits used for the amortization of URR, DAC and VOBA. The change represents a change in accounting estimate effected by a change in accounting principle and is included within our annual reviews and update of assumptions and other refinements. The change in accounting estimate reflected insights gained from revised cashflow modeling enabled by a systems conversion, which prompted the change to a preferable accounting method. We view this new methodology as preferable as we believe it better reflects the economics of our reinsurance transactions by aligning the results of our reinsurance activity more closely to the underlying direct insurance activity and by better reflecting the profit pattern of this business for purposes of the amortization of the balances noted above.

Adoption of New Accounting Pronouncements

On August 15, 2018, the Financial Accounting Standards Board issued Accounting Standards Update ("ASU") 2018-12, Financial Services - Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts, which is expected to have a significant impact on the Company's Consolidated Financial Statements and Notes to the Consolidated Financial Statements. The ASU is effective January 1, 2021 (with early adoption permitted), and will impact, at least to some extent, the accounting and disclosure requirements for all long-duration insurance and investment contracts issued by the Company. See Note 2 to the Consolidated Financial Statements for a more detailed discussion of ASU 2018-12, as well as other accounting pronouncements issued but not yet adopted and newly adopted accounting pronouncements.

Results of Operations by Segment

PGIM Division

PGIM

Business Update

We regularly review our existing businesses and may seek to deploy capital in support of our strategy or to exit an operation if it is determined that it no longer aligns with our broader strategy.

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- In the fourth quarter of 2018, we reached a preliminary agreement with Dewan Housing Finance Corporation Limited ("DHFL") to acquire its stake in our 50/50 joint venture, DHFL Pramerica Asset Managers ("DPAM"), an India-based asset management company. Upon close of the transaction, DPAM will become a wholly-owned business with no change to the scope of its business. The transaction, which is subject to signing of definitive documentation, customary closing conditions and regulatory and other approvals, is currently expected to close during the first half of 2019.

- In the fourth quarter of 2018, we entered into an agreement to acquire Wadhwani Asset Management LLP ("WAM"), a London-based quantitative macro-focused investment management firm. As a result of this transaction, which closed in January 2019, WAM will become part of our QMA business.

- In the second quarter of 2018, we exited our PGIM Brazil operations including the sale of our minority interest in a Brazilian asset management joint venture. The results of this divested business and impact of the sale are reflected in our Corporate and Other operations (see "—Results of Operations by Segment—Divested and Run-off Businesses—Divested and Run-off Businesses Included in Corporate and Other" for additional information).

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Operating Results

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

| | Year ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | (in millions) | | |
| Operating results(1): | | | |
| Revenues | $3,294 | $3,355 | $2,961 |
| Expenses | 2,335 | 2,376 | 2,174 |
| Adjusted operating income | 959 | 979 | 787 |
| Realized investment gains (losses), net, and related adjustments | (10) | (4) | (6) |
| Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests | (21) | 95 | 45 |
| Income (loss) before income taxes and equity in earnings of operating joint ventures | $928 | $1,070 | $826 |

(1) Certain of our PGIM segment's investment activities are based in currencies other than the U.S. dollar and are therefore subject to foreign currency exchange rate risk. For each of the periods presented, the financial results of our PGIM segment include the impact of an intercompany arrangement with our Corporate and Other operations designed to mitigate the impact of exchange rate changes on the segment's U.S. dollar-equivalent earnings. For more information related to this intercompany arrangement, see "—Results of Operations—Impact of Foreign Currency Exchange Rates," above.

Adjusted Operating Income

2018 to 2017 Annual Comparison. Adjusted operating income decreased $20 million. The decrease primarily reflected lower other related revenues, net of associated expenses, driven by lower net performance-based incentive fees and lower strategic investing results due to less favorable investment performance. Also contributing to the decrease was higher non-compensation expenses supporting business growth. Partially offsetting these decreases were higher asset management fees, net of related expenses, driven by an increase in average assets under management as a result of equity market appreciation and continued strong fixed income flows, partially offset by equity outflows.

2017 to 2016 Annual Comparison. Adjusted operating income increased $192 million. The increase primarily reflected higher asset management fees, net of related expenses, driven by an increase in average assets under management as a result of net fixed income inflows, market appreciation, and a favorable fee rate modification within certain real estate funds that occurred in the third quarter of 2016. Also contributing to the increase were higher other related revenues, net of associated expenses, driven by higher strategic investing results due to favorable investment performance, higher net performance-based incentive fees, and an increase in commercial mortgage agency loan originations. These increases were partially offset by higher expenses.

Revenues and Expenses

The following table sets forth the PGIM segment's revenues, presented on a basis consistent with the table above under "—Operating Results," by type.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | (in millions) | | |
| Revenues by type: | | | |
| Asset management fees by source: | | | |
| Institutional customers | $ 1,204 | $ 1,147 | $ 1,046 |
| Retail customers(1) | 867 | 800 | 707 |
| General account | 471 | 470 | 474 |
| Total asset management fees | 2,542 | 2,417 | 2,227 |
| Other related revenues by source: | | | |
| Incentive fees | 59 | 197 | 108 |
| Transaction fees | 33 | 27 | 19 |
| Strategic investing | 57 | 88 | 25 |
| Commercial mortgage(2) | 121 | 127 | 103 |
| Total other related revenues(3) | 270 | 439 | 255 |
| Service, distribution and other revenues(4) | 482 | 499 | 479 |
| Total revenues | $ 3,294 | $ 3,355 | $ 2,961 |

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(1) Consists of fees from: individual mutual funds and variable annuities and variable life insurance separate account assets; funds invested in proprietary mutual funds through our defined contribution plan products; and third-party sub-advisory relationships. Revenues from fixed annuities and the fixed-rate accounts of variable annuities and variable life insurance are included in the general account.

(2) Includes mortgage origination and spread lending revenues from our commercial mortgage origination and servicing business.

(3) Future revenues will be impacted by the level and diversification of our strategic investments, the commercial real estate market, and other domestic and international markets.

(4) 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 $70 million in 2018, $80 million in 2017 and $84 million in 2016.

2018 to 2017 Annual Comparison. Revenues decreased $61 million. Total asset management fees increased $125 million primarily driven by an increase in average assets under management as a result of equity market appreciation and continued strong fixed income flows, partially offset by equity outflows. This increase was more than offset by a decrease of $169 million in other related revenues due to lower gross performance-based incentive fees and lower strategic investing results driven by less favorable investment performance.

Expenses decreased $41 million, reflecting lower compensation attributable to lower earnings, partially offset by an increase in non-compensation expenses due to business growth.

2017 to 2016 Annual Comparison. Revenues increased $394 million. Total asset management fees increased $190 million primarily as a result of net inflows within fixed income, market appreciation, and the impact of a favorable fee rate modification within certain real estate funds. Other related revenues increased $184 million primarily due to an increase in gross performance-based incentive fees related to certain fixed income funds, higher strategic investing results driven by favorable investment performance, and an increase in commercial mortgage agency loan originations. Service, distribution and other revenues increased $20 million reflecting higher net investment income and other revenue related to certain consolidated funds.

Expenses increased $202 million, primarily reflecting higher compensation attributable to higher earnings, as well as an increase in non-compensation related expenses.

Assets Under Management

The following table sets forth assets under management by asset class and source as of the dates indicated.

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| | December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | (in billions) | | |
| Assets Under Management (at fair value): | | | |
| Institutional customers: | | | |
| Equity | $54.7 | $68.0 | $59.3 |
| Fixed income | 395.1 | 379.4 | 332.2 |
| Real estate | 43.7 | 42.1 | 40.0 |
| Institutional customers(1) | 493.5 | 489.5 | 431.5 |
| Retail customers: | | | |
| Equity | 112.9 | 132.4 | 112.4 |
| Fixed income | 125.2 | 111.5 | 94.5 |
| Real estate | 2.0 | 1.7 | 2.3 |
| Retail customers(2) | 240.1 | 245.6 | 209.2 |
| General account: | | | |
| Equity | 5.1 | 5.8 | 6.4 |
| Fixed income | 420.8 | 412.5 | 391.3 |
| Real estate | 1.9 | 1.9 | 1.7 |
| General account | 427.8 | 420.2 | 399.4 |
| Total PGIM assets under management | $1,161.4 | $1,155.3 | $1,040.1 |
| Assets under management within other reporting segments(3) | 215.9 | 238.3 | 223.7 |
| Total PFI assets under management | $1,377.3 | $1,393.6 | $1,263.8 |

(1) Consists of third-party institutional assets and group insurance contracts.

(2) Consists of: individual mutual funds and variable annuities and variable life insurance separate account assets; funds invested in proprietary mutual funds through our defined contribution plan products; and third-party sub-advisory relationships. Fixed annuities and the fixed-rate accounts of variable annuities and variable life insurance are included in the general account.

(3) These amounts primarily include certain assets related to annuity and variable life products in our U.S. Individual Solutions division, retirement and group life products in our U.S. Workplace Solutions division and certain general account assets of our International Insurance division. These assets are not directly managed by PGIM, but rather are invested in non-proprietary funds or are managed by either the divisions themselves or our Chief Investment Officer Organization.

The following table sets forth the component changes in PGIM's assets under management by asset source for the periods indicated.

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| | December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | (in billions) | | |
| Institutional Customers: | | | |
| Beginning assets under management | $489.5 | $431.5 | $389.1 |
| Net additions (withdrawals), excluding money market activity: | | | |
| Third-party | 14.1 | 11.6 | 5.3 |
| Third-party via affiliates(1) | (0.5) | 2.4 | 0.8 |
| Total | 13.6 | 14.0 | 6.1 |
| Market appreciation (depreciation)(2) | (10.3) | 42.9 | 24.2 |
| Other increases (decreases)(3) | 0.7 | 1.1 | 12.1 |
| Ending assets under management | $493.5 | $489.5 | $431.5 |
| Retail Customers: | | | |
| Beginning assets under management | $245.6 | $209.2 | $197.3 |
| Net additions (withdrawals), excluding money market activity: | | | |
| Third-party | (0.4) | 4.1 | 0.4 |
| Third-party via affiliates(1) | 2.3 | (2.0) | (0.5) |
| Total | 1.9 | 2.1 | (0.1) |
| Market appreciation (depreciation)(2) | (7.2) | 34.6 | 9.1 |
| Other increases (decreases)(3) | (0.2) | (0.3) | 2.9 |
| Ending assets under management | $240.1 | $245.6 | $209.2 |
| General Account: | | | |
| Beginning assets under management | $420.2 | $399.4 | $376.7 |
| Net additions (withdrawals), excluding money market activity: | | | |
| Third-party | 0.0 | 0.0 | 0.0 |
| Affiliated | 9.2 | 3.9 | 8.9 |
| Total | 9.2 | 3.9 | 8.9 |
| Market appreciation (depreciation)(2) | (4.2) | 15.1 | 13.3 |
| Other increases (decreases)(3) | 2.6 | 1.8 | 0.5 |
| Ending assets under management | $427.8 | $420.2 | $399.4 |

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(1) Represents assets that our PGIM segment manages for the benefit of other reporting segments within the Company. Additions and withdrawals of these assets are attributable to third-party product inflows and outflows in other reporting segments.

(2) Includes income reinvestment, where applicable.

(3) Includes the effect of foreign exchange rate changes, net money market activity primarily related to cash collateral received or released in conjunction with our Annuities’ living benefits hedging program, and the impact of acquired business. The impact from foreign currency fluctuations, which primarily impact the general account, resulted in gains of $1.2 billion, $4.7 billion and $2.7 billion for the years ended December 31, 2018, 2017 and 2016, respectively.

Strategic Investments

The following table sets forth the strategic investments of the PGIM 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.

| December 31, | |
|---|---|
| 2018 | 2017 |

| | (in millions) | |
|---|---|---|
| Co-Investments: | | |
| Real estate | $207 | $185 |
| Fixed income | 438 | 584 |
| Seed Investments: | | |
| Real estate | 50 | 50 |
| Public equity | 738 | 658 |
| Fixed income | 272 | 309 |
| Total | $1,705 | $1,786 |

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The decrease in strategic investments was primarily driven by relatively lower performance in certain strategies and sales of investments in U.S. collateralized loan obligations ("CLOs") due to risk retention rules that were vacated in April 2018. This decrease was partially offset by investments in new CLOs and seed investments in new mutual funds, exchange-traded funds and undertakings for collective investment in transferable securities ("UCITs").

U.S. Workplace Solutions Division

Retirement

Operating Results

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

| | Year ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | (in millions) | | |
| Operating results(1): | | | |
| Revenues | $16,825 | $13,843 | $12,876 |
| Benefits and expenses | 15,776 | 12,599 | 11,864 |
| Adjusted operating income | 1,049 | 1,244 | 1,012 |
| Realized investment gains (losses), net, and related adjustments | (249) | (62) | (281) |
| Related charges | (5) | (90) | (272) |
| Investment gains (losses) on assets supporting experience-rated contractholder liabilities, net | (588) | 118 | (21) |
| Change in experience-rated contractholder liabilities due to asset value changes | 435 | 67 | 25 |
| Income (loss) before income taxes and equity in earnings of operating joint ventures | $642 | $1,277 | $463 |

(1) Certain of our Retirement segment's non-U.S. dollar-denominated earnings are from longevity reinsurance contracts, which are denominated in British pounds sterling, and are therefore subject to foreign currency exchange rate risk. For the years ended December 31, 2017 and 2016, the financial results of our Retirement segment include the impact of an intercompany arrangement with our Corporate and Other operations designed to mitigate the impact of exchange rate changes on the segment's U.S. dollar-equivalent earnings. Effective January 1, 2018 this intercompany arrangement was terminated and the foreign currency exchange rate risk is now managed within our Retirement segment using a strategy that may include external hedges. The impact of the agreement and the termination was not significant to the segment's results. For more information related to this intercompany arrangement, see "—Results of Operations—Impact of Foreign Currency Exchange Rates," above.

Adjusted Operating Income

2018 to 2017 Annual Comparison. Adjusted operating income decreased $195 million. Results for 2018 and 2017 reflected a net charge of $68 million and $20 million, respectively, from our annual reviews and update of assumptions and other refinements. Excluding these impacts, adjusted operating income decreased $147 million, primarily driven by lower net investment spread results and higher general and administrative expenses, partially offset by more favorable reserve experience. The decrease in net investment spread results primarily reflected lower income on non-coupon investments and lower net prepayment fee income, partially offset by growth in average account values, including growth within our pension risk transfer business. The increase in general and administrative expenses was primarily driven by higher operating expenses driven by business growth. The higher contribution from reserve experience primarily reflected higher mortality gains on a comparative basis for existing contracts.

2017 to 2016 Annual Comparison. Adjusted operating income increased $232 million. Results for 2017 and 2016 reflected a net charge of $20 million and a net benefit of $6 million, respectively, from our annual reviews and update of assumptions and other refinements. Excluding this unfavorable comparative impact, adjusted operating income increased $258 million, primarily driven by higher net investment spread results, a higher contribution from reserve experience and higher fee income. The increase in net investment spread results primarily reflected higher income on non-coupon investments, higher invested assets and net prepayment fee income, partially offset by lower reinvestment rates net of crediting rate actions on full service general account stable value products. The higher contribution from reserve experience primarily reflected higher mortality gains on a comparative basis for existing contracts and growth within our pension risk transfer business. Higher fee income primarily reflected growth in full service average account values driven by market appreciation.

Revenues, Benefits and Expenses

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2018 to 2017 Annual Comparison. Revenues increased $2,982 million. Premiums increased $3,053 million, primarily driven by new pension risk transfer transactions. This increase in premiums resulted in a corresponding increase in policyholders' benefits, as discussed below. Net investment income decreased $105 million, primarily reflecting lower income on non-coupon investments and lower net prepayment fee income, partially offset by higher asset balances, including growth within our pension risk transfer business.

Benefits and expenses increased $3,177 million. Excluding the impact of our annual reviews and update of assumptions, as discussed above, benefits and expenses increased $3,129 million primarily driven by an increase in policyholders' benefits, including the change in policy reserves, related to the increase in premiums discussed above.

2017 to 2016 Annual Comparison. Revenues increased $967 million. Premiums increased $699 million, primarily driven by new pension risk transfer transactions. This increase in premiums resulted in a corresponding increase in policyholders' benefits, as discussed below. Net investment income increased $219 million, primarily reflecting higher income on non-coupon investments and higher invested assets, partially offset by lower reinvestment rates. Policy charges and fee income, asset management and service fees and other income increased $49 million, primarily driven by higher fee income from growth in full service average account values driven by market appreciation.

Benefits and expenses increased $735 million. Excluding the impact of our annual reviews and update of assumptions and other refinements, as discussed above, benefits and expenses increased $709 million primarily driven by an increase in policyholders' benefits, including the change in policy reserves, related to the increase in premiums discussed above.

Account Values

Account values are a significant driver of our operating results, and are primarily driven by net additions (withdrawals) and the impact of market changes. The income we earn on most of our fee-based products varies with the level of fee-based account values, since many policy fees are determined by these values. The investment income and interest we credit to policyholders on our spread-based products varies with the level of general account values. To a lesser extent, changes in account values impact 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 plan sales and participant deposits or additions, as applicable, minus plan and participant withdrawals and benefits. 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 "—PGIM."

| | Year ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | (in millions) | | |
| Full Service: | | | |
| Beginning total account value | $234,616 | $202,802 | $188,961 |
| Deposits and sales | 33,116 | 29,527 | 21,928 |
| Withdrawals and benefits | (26,429) | (24,811) | (20,127) |
| Change in market value, interest credited and interest income and other activity | (9,634) | 27,098 | 12,040 |
| Ending total account value | $231,669 | $234,616 | $202,802 |
| Institutional Investment Products: | | | |
| Beginning total account value | $194,492 | $183,376 | $179,964 |
| Additions(1) | 21,310 | 21,630 | 16,140 |
| Withdrawals and benefits | (15,409) | (17,406) | (12,161) |
| Change in market value, interest credited and interest income | 3,303 | 5,190 | 5,299 |
| Other(2) | (2,937) | 1,702 | (5,866) |

| Ending total account value | $200,759 | $194,492 | $183,376 |
| --- | --- | --- | --- |

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(1) Additions primarily include: group annuities calculated based on premiums received; longevity reinsurance contracts calculated as the present value of future projected benefits; and investment-only stable value contracts calculated as the fair value of customers' funds held in a client-owned trust.

(2) "Other" activity includes the effect of foreign exchange rate changes associated with our British pounds sterling denominated longevity reinsurance business and changes in asset balances for externally-managed accounts. For the years ended December 31, 2018 and 2017, "other" activity also includes $3,497 million in receipts offset by $3,457 million in payments and $4,782 million in receipts offset by $4,375 million in payments, respectively, related to funding agreements backed by commercial paper which typically have maturities of less than 90 days.

2018 to 2017 Annual Comparison. The decrease in full service account values primarily reflected the unfavorable changes in the market value of customer funds, partially offset by positive net plan sales.

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The increase in institutional investment products account values primarily reflected net additions from pension risk transfer transactions.

2017 to 2016 Annual Comparison. The increase in full service account values primarily reflected the favorable changes in the market value of customer funds and the addition of a significant defined contribution transaction. The increase in net additions was primarily driven by higher large plan sales, partially offset by higher large plan lapses.

The increase in institutional investment products account values primarily reflected net additions from pension risk transfer transactions, interest credited on customer funds and the impact from foreign currency fluctuations on longevity reinsurance account values, partially offset by net withdrawals from investment-only stable value accounts. The increase in net additions was primarily driven by higher net additions related to pension risk transfer transactions, partially offset by investment-only stable value accounts, which reflected net withdrawals in 2017 compared to net additions in 2016.

Group Insurance

Business Update

During the second quarter of 2018, we entered into a yearly renewable term reinsurance agreement with certain external counterparties to reinsure a portion of the mortality risk associated with our group life business. This resulted in a reduction in risk-based capital required to be held in the segment. Under U.S. GAAP, this agreement is accounted for under deposit accounting. Following this transaction, we expect a modest negative impact on the segment's adjusted operating income as a result of risk charge expenses associated with this reinsurance arrangement and a reduction in investment income because we were able to release capital from the segment as a result of the transaction.

Operating Results

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

| | Year ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | (in millions) | | |
| Operating results: | | | |
| Revenues | $5,685 | $5,471 | $5,343 |
| Benefits and expenses | 5,456 | 5,218 | 5,123 |
| Adjusted operating income | 229 | 253 | 220 |
| Realized investment gains (losses), net, and related adjustments | (38) | (53) | (8) |
| Related charges | 0 | 0 | (6) |
| Income (loss) before income taxes and equity in earnings of operating joint ventures | $191 | $200 | $206 |
| Benefits ratio(1): | | | |
| Group life(2) | 87.2% | 88.9% | 89.1% |
| Group disability(2) | 75.8% | 71.8% | 75.7% |
| Total Group insurance(2) | 84.9% | 85.8% | 86.7% |
| Administrative operating expense ratio(3): | | | |
| Group life | 12.2% | 11.2% | 10.6% |
| Group disability | 27.0% | 29.4% | 31.4% |
| Total Group Insurance | 15.1% | 14.6% | 14.3% |

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(1) Ratio of policyholder benefits to earned premiums plus policy charges and fee income.

(2) Benefits ratios reflect the impacts of our annual reviews and update of assumptions and other refinements. Excluding these impacts, the group life, group disability and total Group Insurance benefits ratios were 87.4%, 77.8% and 85.5% for 2018, respectively, 88.7%, 78.9% and 86.9% for 2017, respectively, and 88.5%, 82.9% and 87.5% for 2016, respectively.

(3) Ratio of general and administrative expenses (excluding commissions) to gross premiums plus policy charges and fee income.

Adjusted Operating Income

2018 to 2017 Annual Comparison. Adjusted operating income decreased $24 million, including an unfavorable comparative net impact from our annual reviews and update of assumptions and other refinements. Results for 2018 included a $31 million net benefit from these updates while results for 2017 included a $55 million net benefit from these updates. The net benefit in both periods was primarily driven by favorable experience related to our group disability business. Excluding the effect of these items, adjusted operating income was in line with the prior year, reflecting more favorable underwriting results in our group life and group disability businesses primarily driven by business growth, offset by higher expenses, including expenses related to business growth, and a lower contribution from net investment spread results driven by lower income on non-coupon investments.

2017 to 2016 Annual Comparison. Adjusted operating income increased $33 million, including favorable comparative net impacts from our annual reviews and update of assumptions and other refinements. Results for 2017 included a $55 million net benefit from these updates while results for 2016 included a $41 million net benefit. The net benefit in both periods was primarily driven by favorable experience related to our group disability business. Excluding the effect of these items, adjusted operating income increased $19 million, primarily reflecting favorable underwriting results in our group disability business and a higher contribution from net investment spread results, partially offset by higher expenses.

Revenues, Benefits and Expenses

2018 to 2017 Annual Comparison. Revenues increased $214 million. Excluding an unfavorable comparative impact of $5 million resulting from our annual reviews and update of assumptions and other refinements, as discussed above, revenues increased $219 million. The increase primarily reflected higher premiums and policy charges and fee income driven by business growth in both our group life and group disability businesses, partially offset by lower income on non-coupon investments.

Benefits and expenses increased $238 million. Excluding an unfavorable comparative impact of $19 million resulting from our annual reviews and update of assumptions and other refinements, as discussed above, benefits and expenses increased $219 million. The increase primarily reflected higher policyholders' benefits and changes in reserves driven by the growth in premiums discussed above, and an increase in general and administrative expenses driven by higher operating expenses from business growth and the termination of a third-party underwriting service provider contract in the second quarter of 2018.

2017 to 2016 Annual Comparison. Revenues increased $128 million. Excluding an unfavorable comparative impact of $37 million resulting from our annual reviews and update of assumptions and other refinements, revenues increased $165 million. The increase reflected $135 million of higher premiums and policy charges and fee income, primarily driven by the increase in new business in both our group life and group disability businesses, as well as higher premiums on experience-rated contracts in our group life business with corresponding offsets in benefits and expenses. Net investment income increased $29 million primarily driven by higher income from non-coupon investments.

Benefits and expenses increased $95 million. Excluding a favorable comparative impact of $51 million resulting from our annual reviews and update of assumptions and other refinements, benefits and expenses increased $146 million. This increase primarily reflected higher policyholders' benefits and changes in reserves, driven by higher benefits on group life experience-rated contracts, as discussed above, higher benefit payments in our group disability business and our non-experience rated group life contracts, and higher general and administrative expenses.

Sales Results

The following table sets forth the Group Insurance segment's annualized new business premiums, as defined under "—Segment Measures" above, for the periods indicated.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | (in millions) | | |
| Annualized new business premiums(1): | | | |
| Group life | $ 376 | $ 287 | $ 316 |
| Group disability | 183 | 153 | 119 |
| Total | $ 559 | $ 440 | $ 435 |

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(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.

2018 to 2017 Annual Comparison. Total annualized new business premiums increased $119 million reflecting continued growth through sales to new and existing clients in both our group life and group disability businesses.

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2017 to 2016 Annual Comparison. Total annualized new business premiums increased $5 million primarily driven by sales to new clients in our group disability business, partially offset by lower sales in our group life business, which included a large client sale in 2016.

U.S. Individual Solutions Division

Individual Annuities

The Individual Annuities segment includes both variable and fixed annuities that may include optional guaranteed living benefits riders (e.g., GMIB, GMAB, GMWB and GMIWB), and/or GMDB. We also offer fixed annuities that provide a guarantee of principal and interest credited at rates we determine (subject to certain contractual minimums) or at rates based upon the performance of an index (subject to caps). We derive our revenue mainly from fee income generated on variable annuity account values, as the investment return on these contractholder funds is generally attributed directly to the contractholder. We also earn investment income on general account assets supporting annuity account values and certain other management fees. Our expenses primarily consist of interest credited and other benefits to contractholders, amortization of DAC and other costs, non-deferred expenses related to the selling and servicing of the various products we offer, costs of managing certain risks associated with these products, changes in the reserves for benefit guarantees and other general business expenses. These drivers of our business results are generally included in adjusted operating income, with exceptions related to certain guarantees, as discussed below.

The U.S. GAAP accounting and our adjusted operating income treatment for our guarantees differ depending upon the specific contractual features. Under U.S. GAAP, the reserves for GMDB and GMIB are calculated based on best estimates applying our actuarial and capital markets return assumptions in accordance with an insurance fulfillment accounting framework. Under this framework, a liability is established over time representing the portion of fees collected that is expected to be used to satisfy the obligation to pay benefits in future periods. The risks associated with these benefit features are retained and results are included in adjusted operating income in a manner generally consistent with U.S. GAAP.

In contrast, certain of our guaranteed living benefit riders (e.g., GMAB, GMWB and GMIWB) are accounted for under U.S. GAAP as embedded derivatives and reported using a fair value accounting framework. These benefit features are carried at fair value, based on estimates of assumptions a market participant would use in valuing these embedded derivatives, and the change in fair value during each reporting period is recorded within “Realized investment gains (losses), net.” For purposes of measuring segment performance, adjusted operating income excludes the changes in fair value and instead reflects the performance of these riders using an insurance fulfillment accounting framework. Under this framework, adjusted operating income recognized each period reflects the rider fees earned during the period, less the portion of such fees estimated to be required to cover future benefit payments and hedging costs. For more information on how we determine the portion of fees needed to cover estimated future benefit payments and hedging costs, see “Variable Annuity Risks and Risk Mitigants” below.

Operating Results

The following table sets forth the Individual Annuities segment’s operating results for the periods indicated.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | (in millions) | | |
| Operating results: | | | |
| Revenues | $4,966 | $5,110 | $4,666 |

| | | | |
|---|---|---|---|
| Benefits and expenses | 3,041 | 2,912 | 2,901 |
| Adjusted operating income | 1,925 | 2,198 | 1,765 |
| Realized investment gains (losses), net, and related adjustments | 846 | (1,157 ) | 2,031 |
| Related charges | (407 ) | 577 | 68 |
| Income (loss) before income taxes and equity in earnings of operating joint ventures | $2,364 | $1,618 | $3,864 |

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Adjusted Operating Income

2018 to 2017 Annual Comparison. Adjusted operating income decreased $273 million. Excluding the impacts of changes in the estimated profitability of the business, discussed below, adjusted operating income decreased $56 million. The decrease was primarily driven by lower net investment spread results reflecting lower investment income on non-coupon investments, higher capital hedge costs, and higher distribution expenses due to increased sales. Partially offsetting these decreases were lower amortization costs and reserve provisions as well as higher asset-based fee income, net of associated costs. The increase in the net asset-based fee income reflected higher average variable annuity account values due to market appreciation and favorable impacts related to our living benefit guarantees, partially offset by negative net flows and the impact of certain products reaching contractual milestones for fee tier reduction.

The impacts of changes in the estimated profitability of the business include adjustments to the amortization of DAC and other costs as well as to the reserves for certain living and/or death benefit features of our variable annuity products. These adjustments resulted in a net charge of $34 million and a net benefit of $183 million in 2018 and 2017, respectively, reflecting the net impact of hedge effectiveness relative to our assumptions, as well as a net benefit resulting from our annual reviews and update of assumptions and other refinements. Additionally, the net benefit of $183 million also reflected the net impact of equity market performance on contractholder accounts.

2017 to 2016 Annual Comparison. Adjusted operating income increased $433 million. Excluding the impacts of changes in the estimated profitability of the business, discussed below, adjusted operating income increased $388 million. The increase was primarily driven by higher asset-based fee income, net of associated costs, lower amortization costs and reserve provisions, and higher net investment spread results. The increase in asset-based fee income, net of a related increase in asset-based commissions, reflects higher average variable annuity account values due to market appreciation; and the impact of greater efficiencies in managing product risks associated with the Asset Liability Management strategy that was implemented in the third quarter of 2016. The increase in net investment spread results reflects higher investment income on non-coupon investments as well as a higher level of invested assets.

The adjustments to the amortization of DAC and other costs and to the reserves for certain living and/or death benefit features of our variable annuity products resulted in a net benefit of $183 million in 2017, as discussed above, and a net benefit of $138 million in 2016 primarily reflecting the net impact of equity market performance on contractholder accounts, hedge effectiveness relative to our assumptions, and a net benefit resulting from our annual reviews and update of assumptions and other refinements.

Revenues, Benefits and Expenses

2018 to 2017 Annual Comparison. Revenues decreased $144 million. Excluding a $93 million net decrease related to the impacts of certain changes in our estimated profitability of the business, as discussed above, revenues decreased $51 million. The decrease is primarily due to a decrease in net investment spread results reflecting lower investment income on non-coupon investments, as well as a decrease in asset management and services fees and other income attributable to higher capital hedge costs. These decreases were partially offset by an increase in premiums reflecting an increase in annuitizations of our variable annuity contracts, with offsets in policyholders' benefits, as discussed below. Also contributing to the partial offset was an increase in policy charges and fee income reflecting higher average variable annuity account values due to market appreciation and favorable impacts related to our living benefit guarantees, partially offset by negative net flows and the impact of certain products reaching contractual milestones for fee tier reduction.

Benefits and expenses increased $129 million. Excluding a $124 million net increase related to the impacts of certain changes in our estimated profitability of the business, as discussed above, benefits and expenses increased $5 million. General and administrative expenses, net of capitalization, increased $27 million due to higher distribution expenses driven by higher sales, as well as higher technology costs. Policyholders' benefits, including changes in reserves, increased $9 million primarily due to higher reserve provisions and annuitizations, as discussed above. These increases were partially offset by a decrease of $17 million in interest credited to policyholders' account balance, and a decrease of $11 million in amortization of acquisition costs.

2017 to 2016 Annual Comparison. Revenues increased $444 million. Excluding an $85 million net increase related to the impacts of certain changes in our estimated profitability of the business, as discussed above, revenues increased $359 million. Higher average variable annuity account values and the impact from refinements to our risk management strategy drove increases in policy charges and fee income, and asset management and service fees and other income. The increase in net investment income was driven by higher income from non-coupon investments and a higher level of invested assets.

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Benefits and expenses increased $11 million. Excluding a $40 million net increase related to the impacts of certain changes in our estimated profitability of the business, as discussed above, benefits and expenses decreased $29 million, primarily driven by a decrease in policyholders' benefits, including changes in reserves. Partially offsetting this decrease were higher general and administrative expenses, net of capitalization, primarily driven by higher asset management costs and higher asset-based commissions due to higher average account values, as well as from higher net operating expenses, including those supporting business growth initiatives.

Account Values

Account values are a significant driver of our operating results. Since most fees are determined by the level of separate account assets, fee income varies according to the level of account values. Additionally, our fee income generally drives other items such as the pattern of amortization of DAC and other costs. Account values are driven by net flows from new business sales, surrenders, withdrawals and benefit payments, policy charges and the impact of positive or negative market value changes. The annuity industry's competitive and regulatory landscapes, which have been dynamic over the last few years, may impact our net flows, including new business sales. The following table sets forth account value information for the periods indicated.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | (in millions) | | |
| Total Individual Annuities(1): | | | |
| Beginning total account value | $168,626 | $156,783 | $152,945 |
| Sales | 8,270 | 5,894 | 8,054 |
| Surrenders and withdrawals | (11,688) | (9,821) | (7,881) |
| Net sales (withdrawals) | (3,418) | (3,927) | 173 |
| Benefit payments | (2,084) | (1,873) | (1,794) |
| Net flows | (5,502) | (5,800) | (1,621) |
| Change in market value, interest credited and other activity | (8,341) | 21,355 | 9,012 |
| Policy charges | (3,703) | (3,712) | (3,553) |
| Ending total account value | $151,080 | $168,626 | $156,783 |

(1) Includes variable and fixed annuities sold as retail investment products. Investments sold through defined contribution plan products are included with such products within the Retirement segment. Variable annuity account values were $147.3 billion, $165.1 billion and $153.3 billion as of December 31, 2018, 2017 and 2016, respectively. Fixed annuity account values were $3.7 billion as of December 31, 2018, and $3.5 billion as of December 31, 2017 and 2016.

2018 to 2017 Annual Comparison. The decrease in account values during 2018 was predominantly driven by unfavorable changes in the market value of contractholder funds. This decrease was slightly offset by an increase in net sales reflecting higher gross sales, partially offset by higher surrenders and withdrawals as well as benefit payments and policy charges that were generally in line with prior periods.

2017 to 2016 Annual Comparison. The increase in account values during 2017 was predominantly driven by favorable changes in the market value of contractholder funds. Net sales for 2017 decreased compared to 2016 reflecting lower gross sales and higher surrenders and withdrawals. The decline in gross sales for 2017 compared to 2016 was largely driven by the continued impact stemming from the evolving U.S. Department of Labor fiduciary rules and an industry shift away from variable annuity products.

Variable Annuity Risks and Risk Mitigants

The primary risk exposures of our variable annuity contracts relate to actual deviations from, or changes to, the assumptions used in the original pricing of these products, including capital markets assumptions such as equity market returns, interest rates and market volatility, along with actuarial assumptions such as contractholder mortality, the timing and amount of annuitization and withdrawals, and contract lapses. For these risk exposures, achievement of our expected returns and profitability is subject to the risk that actual experience will differ from the assumptions used in the original pricing of these products. We currently manage our exposure to certain risks driven by fluctuations in capital markets primarily through a combination of Product Design Features, an Asset Liability Management Strategy, a Capital Hedge Program and External Reinsurance.

Product Design Features

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A portion of the variable annuity contracts that we offer include an automatic rebalancing feature, also referred to as an asset transfer feature. This feature is implemented at the contract level, and transfers assets between certain variable investment sub-accounts selected by the annuity contractholder and, depending on the benefit feature, a fixed-rate account in the general account or a bond fund sub-account within the separate accounts. The automatic rebalancing feature associated with currently-sold highest daily benefit products uses a designated bond fund sub-account within the separate accounts. The transfers are based on a 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. The objective of the automatic rebalancing feature is to reduce our exposure to equity market risk and market volatility. Other product design features we utilize include, among others, asset allocation restrictions, minimum issuance age requirements and certain limitations on the amount of contractholder deposits, as well as a required minimum allocation to our general account for certain of our products. We continue to introduce products that diversify our risk profile and have incorporated provisions in product design allowing frequent revisions of key pricing elements for certain of our products. In addition, there is diversity in our fee arrangements, as certain fees are primarily based on the benefit guarantee amount, the contractholder account value and/or premiums, which helps preserve certain revenue streams when market fluctuations cause account values to decline.

Asset Liability Management ("ALM") Strategy (including fixed income instruments and derivatives)

Under our historical hedging program to manage certain capital market risks associated with certain variable annuity living benefit guarantees, we utilized the U.S. GAAP valuation, with certain modifications, to derive a hedge target that was more reflective of our best estimate of future benefit payments, net of fees collected. Derivative positions were entered into that sought to offset the change in value of the hedge target.

During the third quarter of 2016, we implemented a new ALM strategy that utilizes a combination of both traditional fixed income instruments and derivatives to help defray potential claims associated with our variable annuity living benefit guarantees. The economic liability we manage with this ALM strategy consists of expected living benefit claims under less severe market conditions, which are managed through the accumulation of fixed income instruments, and potential living benefit claims resulting from more severe market conditions, which are hedged using derivative instruments. For the portion of our ALM strategy executed with derivatives, we enter into a range of exchange-traded, cleared, and OTC equity and interest rate derivatives, including, but not limited to: equity and treasury futures; total return and interest rate swaps; and options, including equity options, swaptions, and floors and caps. The intent of this strategy is to more efficiently manage the capital and liquidity associated with these products while continuing to mitigate fluctuations in net income due to movements in capital markets.
The change in hedge strategy had no impact on how we value or account for the living benefit guarantees under U.S. GAAP. However, under the ALM strategy that began in the third quarter of 2016, adjusted operating income includes the fees earned that are in excess of the estimated portion of fees required to cover expected claims and hedge costs for the economic liability. The portion of fees required to cover such costs is updated quarterly to reflect updated estimates and actual experience. The effectiveness of our hedging program as measured by comparing the change in value of our hedging assets to the change in value of the liability we are attempting to hedge will ultimately be reflected in adjusted operating income over time through the inclusion of actual hedge costs. Expected costs are updated periodically along with our expectation of claims. For adjusted operating income purposes, DAC and other costs are fully amortized over the life of the contracts proportional to our actual and estimated gross profits under the adjusted operating income framework described above. Overall, we generally expect this strategy to result in a higher portion of fees being recognized in adjusted operating income than under our prior strategy.

The following table provides a reconciliation between the liability reported under U.S. GAAP and the economic liability we manage through our ALM strategy.

| | As of December 31, |
|---|---|

| | 2018 | 2017 |
|---|---|---|
| | (in millions) | |
| U.S. GAAP liability (including non-performance risk) | $8,860 | $8,663 |
| Non-performance risk adjustment | 4,619 | 3,228 |
| Subtotal | 13,479 | 11,891 |
| Adjustments including risk margins and valuation methodology differences | (4,084 ) | (2,742 ) |
| Economic liability managed through the ALM strategy | $9,395 | $9,149 |

As of December 31, 2018, our fixed income instruments and derivative assets exceed the economic liability within the entities in which the risks reside.

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Under our ALM strategy, we expect differences in the U.S. GAAP net income impact between the changes in value of the fixed income instruments and derivatives, as compared to the changes in the embedded derivative liability these assets support. These differences can be primarily attributed to three distinct areas:

- Different valuation methodologies in measuring the liability we intend to cover with fixed income instruments and derivatives versus the liability reported under U.S. GAAP—The valuation methodology utilized in estimating the economic liability we intend to defray with fixed income instruments and derivatives is different from that required to be utilized to measure the liability under U.S. GAAP. Additionally, the valuation of the economic liability excludes certain items that are included within the U.S. GAAP liability, such as NPR (in order to maximize protection irrespective of the possibility of our own default), as well as risk margins (required by U.S. GAAP but different from our best estimate).

- Different accounting treatment between liabilities and assets supporting those liabilities—Under U.S. GAAP, changes in value of the embedded derivative liability and derivative instruments used to hedge a portion of the economic liability are immediately reflected in net income. In contrast, changes in fair value of fixed income instruments that support a portion of the economic liability are designated as available-for-sale and are recorded as unrealized gains (losses) in other comprehensive income rather than within net income.

- General hedge results—For the derivative portion of the ALM strategy, the net hedging impact (the extent to which the changes in value of the hedging instruments offset the change in value of the portion of the economic liability we are hedging) may be impacted by a number of factors including: cash flow timing differences between our hedging instruments and the corresponding portion of the economic liability we are hedging, basis differences attributable to actual underlying contractholder funds to be hedged versus hedgeable indices, rebalancing costs related to dynamic rebalancing of hedging instruments as markets move, certain elements of the economic liability that may not be hedged (including certain actuarial assumptions), and implied and realized market volatility on the hedge positions relative to the portion of the economic liability we seek to hedge.

The following table illustrates the net impact to our Consolidated Statements of Operations from changes in the U.S. GAAP embedded derivative liability and hedge positions under the ALM strategy, and the related amortization of DAC and other costs, that are excluded from adjusted operating income.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | (in millions)(1) | | |
| Excluding impact of assumption updates and other refinements: | | | |
| Net hedging impact(2)(3) | $(234) | $620 | $(692) |
| Change in portions of U.S. GAAP liability, before NPR(4) | (959) | 2,477 | 1,745 |
| Change in the NPR adjustment | 1,472 | (3,890) | (1,097) |
| Net impact from changes in the U.S. GAAP embedded derivative and hedge positions-reported in Individual Annuities | 279 | (793) | (44) |
| Related benefit (charge) to amortization of DAC and other costs | (190) | 159 | 243 |
| Net impact of assumption updates and other refinements | (173) | (85) | 1,455 |
| 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(3) | $(84) | $(719) | $1,654 |

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(1) Positive amount represents income; negative amount represents a loss.

(2) Net hedging impact represents the difference between the change in fair value of the risk we seek to hedge using derivatives and the change in fair value of the derivatives utilized with respect to that risk.

(3) Excludes $(1,523) million for 2016 representing the impact of managing interest rate risk through our Capital Protection Framework prior to the introduction of our new ALM strategy in the third quarter of 2016. Because the decision to manage this risk through the Capital Protection Framework was based on the capital considerations of the Company as a whole, the impact was reported in Corporate and Other operations. See "—Corporate and Other."

(4) Represents risk margins and valuation methodology differences between the economic liability managed by the ALM strategy and the U.S. GAAP liability, as well as the portion of the economic liability managed with fixed income instruments.

The net loss of $84 million for 2018 primarily reflected the impact of a $173 million charge from our annual review and update of assumptions, driven by modifications to both our actuarial assumptions, including updates to expected withdrawal rates, as well as to economic assumptions. These charges were largely offset by changes in the U.S. GAAP embedded derivative and hedge positions as a result of credit spreads widening, partially offset by declining rates and unfavorable equity markets.

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The net loss of $719 million for 2017 primarily reflected the net impact of a $793 million loss from changes in the U.S. GAAP embedded derivative and hedge positions, predominantly driven by a decrease in the NPR adjustment due to tightening of credit spreads used in measuring our living benefits contracts. Partially offsetting this decrease were an increase in the portions of the U.S. GAAP liability before NPR that are excluded from our hedge target and, to a lesser extent, a benefit from net hedging impacts, primarily driven by fund outperformance and favorable liability basis.

The net gain of $1,654 million for 2016 primarily reflected the impact of a $1,455 million benefit from our annual review and update of assumptions, driven by modifications to both our actuarial assumptions, including updates to expected withdrawal rates, as well as economic assumptions. The net gain also reflected the changes in the portions of the U.S. GAAP liability before NPR that are excluded from our hedge target. This impact was partially offset by changes in the NPR adjustment, primarily driven by tightening of credit spreads. To a lesser extent, results also reflected net hedging impacts, primarily driven by unfavorable liability basis. Each of these items had corresponding partial offsets included in the related impacts to amortization of DAC and other costs. Amortization of DAC and other costs also included a benefit of $515 million related to changes in our estimate of total gross profits as a result of the implementation of the new ALM strategy in the third quarter of 2016 described above.

Through March 31, 2016, we reinsured living benefit guarantees issued by our domestic statutory life insurance companies to a captive reinsurance company, Pruco Reinsurance, Ltd. (“Pruco Re”), in order to facilitate the capital markets hedging program for these living benefit guarantees. Effective April 1, 2016, these living benefit guarantees and certain retirement products were recaptured and then reinsured to certain of our domestic statutory life insurance companies. The ALM strategy described above is executed within these domestic insurance companies. After the foregoing transactions, Pruco Re no longer had any material active reinsurance with affiliates. On September 30, 2016, Pruco Re was merged with and into Prudential Annuities Life Assurance Corporation (“PALAC”).

Capital Hedge Program

During 2017, we commenced a capital hedge program within the Individual Annuities segment to further hedge equity market impacts. The program is intended to protect a portion of the overall capital position of the variable annuities business against its exposure to the equity markets. The capital hedge program is conducted using equity derivatives which include equity call and put options, total return swaps and futures contracts. The changes in value of these derivatives are recognized in adjusted operating income over the expected duration of the capital hedge program.

External Reinsurance

As of December 31, 2018, $2.9 billion of Highest Daily Lifetime Income (“HDI”) v.3.0 account values are reinsured to Union Hamilton Reinsurance Ltd., an external counterparty, pursuant to a quota share agreement that covered approximately 50% of new business between April 1, 2015 and December 31, 2016. HDI v.3.0 is the current version of our “highest daily” living benefits guarantee that is available with our Prudential Premier® Retirement Variable Annuity. New sales of HDI v.3.0 subsequent to December 31, 2016 are not covered by this external reinsurance agreement.

Product Specific Risks and Risk Mitigants

For certain living benefits guarantees, claims will primarily represent the funding of contractholder lifetime withdrawals after the cumulative withdrawals have first exhausted the contractholder account value. Due to the age of the in-force block, limited claim payments have occurred to date, and they are not expected to increase significantly within the next five years, based upon current assumptions. The timing and amount of future claims will depend on actual returns on contractholder account value and actual contractholder behavior relative to our assumptions. The

majority of our current living benefits guarantees provide for guaranteed lifetime contractholder withdrawal payments inclusive of a "highest daily" contract value guarantee. Our Prudential Defined Income ("PDI") variable annuity complements our variable annuity products with the highest daily benefit and provides for guaranteed lifetime contractholder withdrawal payments, but restricts contractholder asset allocation to a single bond fund sub-account within the separate accounts.

The majority of our variable annuity contracts with living benefits guarantees, and all new contracts sold with our highest daily living benefits feature, include risk mitigants in the form of an automatic rebalancing feature and/or inclusion in our ALM strategy. We may also utilize external reinsurance as a form of additional risk mitigation. The risks associated with the guaranteed benefits of certain legacy products that were sold prior to our development of the automatic rebalancing feature are also managed through our ALM strategy. Certain legacy GMAB products include the automatic rebalancing feature, but are not included in the ALM strategy. The PDI product and contracts with the GMIB feature have neither risk mitigant. Certain risks associated with PDI are managed through the limitation of contractholder asset allocations to a single bond fund sub-account.



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For our GMDBs, we provide a benefit payable in the event of death. Our base GMDB is generally equal to a return of cumulative deposits adjusted for any partial withdrawals. Certain products include an optional enhanced GMDB based on the greater of a minimum return on the contract value or an enhanced value. We have retained the risk that the total amount of death benefit payable may be greater than the contractholder account value; however, a substantial portion of the account values associated with GMDBs are subject to an automatic rebalancing feature because the contractholder also selected a living benefit guarantee which includes an automatic rebalancing feature. All of the variable annuity account values with living benefit guarantees also contain GMDBs. The living and death benefit features for these contracts cover the same insured life and, consequently, we have insured both the longevity and mortality risk on these contracts.

The following table sets forth the risk management profile of our living benefit guarantees and GMDB features as of the periods indicated.

| | December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2018 | | 2017 | | 2016 | |
| | Account Value | % of Total | Account Value | % of Total | Account Value | % of Total |
| | (in millions) | | | | | |
| Living benefit/GMDB features(1): | | | | | | |
| Both ALM strategy and automatic rebalancing(2) | $101,496 | 69 % | $114,686 | 69 % | $106,585 | 69 % |
| ALM strategy only | 7,520 | 5 % | 9,317 | 6 % | 9,409 | 6 % |
| Automatic rebalancing only | 804 | 1 % | 1,003 | 1 % | 1,168 | 1 % |
| External reinsurance(3) | 2,873 | 2 % | 3,227 | 2 % | 2,932 | 2 % |
| PDI | 11,237 | 7 % | 9,996 | 5 % | 7,926 | 5 % |
| Other Products | 2,306 | 2 % | 2,791 | 2 % | 2,730 | 2 % |
| Total living benefit/GMDB features | $126,236 | | $141,020 | | $130,750 | |
| GMDB features and other(4) | 21,103 | 14 % | 24,133 | 15 % | 22,545 | 15 % |
| Total variable annuity account value | $147,339 | | $165,153 | | $153,295 | |

(1) All contracts with living benefit guarantees also contain GMDB features, covering the same insured contract.
(2) Contracts with living benefits that are included in our ALM strategy and that have an automatic rebalancing feature.
(3) Represents contracts subject to reinsurance transaction with external counterparty covering certain new HDI v.3.0 business for the period April 1, 2015 through December 31, 2016. These contracts with living benefits also have an automatic rebalancing feature.
(4) Includes contracts that have a GMDB feature and do not have an automatic rebalancing feature.

Individual Life

Operating Results

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

| | Year ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | (in millions) | | |
| Operating results: | | | |
| Revenues | $5,831 | $4,974 | $5,355 |

| | | | |
|---|---|---|---|
| Benefits and expenses | 5,608 | 5,165 | 5,276 |
| Adjusted operating income | 223 | (191) | 79 |
| Realized investment gains (losses), net, and related adjustments | (318) | 96 | 58 |
| Related charges | 79 | 101 | (223) |
| Income (loss) before income taxes and equity in earnings of operating joint ventures | $(16) | $6 | $(86) |

Adjusted Operating Income

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2018 to 2017 Annual Comparison. Adjusted operating income increased $414 million, primarily reflecting favorable comparative net impacts from our annual reviews and update of assumptions and other refinements. Results for 2018 included a $65 million net charge from this annual review, mainly driven by unfavorable impacts related to lapse and mortality rate assumptions. Results for 2017 included a $653 million net charge from this annual review mainly driven by a charge related to modeling refinements as a result of a valuation systems conversion, including a change in the method of accounting for reinsurance associated with certain long-duration insurance contracts, and changes in lapse rate assumptions. Excluding these impacts, adjusted operating income decreased $174 million, primarily reflecting lower underwriting results, driven by the unfavorable ongoing impact of our annual reviews and updates of assumptions and other refinements, partially offset by less unfavorable mortality experience, net of reinsurance. The decrease was also driven by a lower contribution from net investment spread results primarily due to lower income on non-coupon investments.

2017 to 2016 Annual Comparison. Adjusted operating income decreased $270 million, primarily reflecting unfavorable comparative net impacts from our annual reviews and update of assumptions and other refinements. Results for 2017 included a $653 million net charge from this annual review, as discussed above. Results for 2016 included a $420 million net charge from this annual review, mainly driven by a charge to accrue a liability to offset the present value of losses expected to be recognized in later years and a charge related to an out of period adjustment, partially offset by a net benefit from the impacts of other refinements. Excluding these impacts, adjusted operating income decreased $37 million, primarily reflecting the unfavorable ongoing impact of our second quarter 2017 annual review and update of assumptions and other refinements, higher general and administrative expenses, including expenses related to business growth initiatives, and an unfavorable impact from mortality experience, net of reinsurance. These decreases were partially offset by a higher contribution from net investment spread results.

Revenues, Benefits and Expenses

2018 to 2017 Annual Comparison. Revenues increased $857 million. Excluding the impact of our annual reviews and update of assumptions and other refinements, as discussed above, revenues increased $80 million. This increase was primarily driven by an increase in net investment income from higher average invested assets, resulting from continued business growth, and higher investment income from unaffiliated reserve financing activity, which resulted in a corresponding increase in interest expense, as discussed below, partially offset by lower income on non-coupon investments. Also contributing to this increase was higher premiums driven by continued business growth. These increases were partially offset by lower revenues reflecting higher ceded net reinsurance premiums, as a result of the unfavorable ongoing impact of the second quarter 2017 change in the method of accounting for reinsurance, which was partially offset by related lower benefits and expenses, as discussed below.

Benefits and expenses increased $443 million. Excluding the impact of our annual reviews and update of assumptions and other refinements, as discussed above, benefits and expenses increased $254 million. This increase was primarily related to higher general and administrative expenses, net of capitalization, reflecting increased VOBA amortization and higher operating expenses, higher reserve financing costs, as discussed above, higher policyholders’ benefits and interest credited to account balances attributable to continued business growth, and increased DAC amortization. These increases were partially offset by the favorable ongoing impact of the second quarter 2017 change in the method of accounting for reinsurance, which was more than offset by the related unfavorable impact in revenues, as discussed above.

2017 to 2016 Annual Comparison. Revenues decreased $381 million. Excluding the impact of our annual reviews and update of assumptions and other refinements, as discussed above, revenues increased $152 million. This increase was primarily driven by an increase in net investment income from higher average invested assets, resulting from continued business growth, higher investment income from unaffiliated reserve financing activity, which resulted in a corresponding increase in interest expense, as discussed below, and higher income on non-coupon investments,

partially offset by lower prepayment fee income. Also contributing to this increase was higher premiums driven by continued business growth. These increases were partially offset by lower revenues reflecting higher ceded net reinsurance premiums, as a result of the unfavorable ongoing impact of the second quarter 2017 change in the method of accounting for reinsurance, which was partially offset by related lower benefits and expenses, as discussed below.

Benefits and expenses decreased $111 million. Excluding the impact of our annual reviews and update of assumptions and other refinements, as discussed above, benefits and expenses increased $189 million. This increase was primarily related to higher general and administrative expenses, net of capitalization, reflecting higher operating expenses including business growth initiatives, higher reserve financing costs, as discussed above, and higher policyholders' benefits and interest credited to account balances attributable to continued business growth and an unfavorable impact from mortality experience, partially offset by the favorable ongoing impact of the second quarter 2017 change in the method of accounting for reinsurance, which was more than offset by the related unfavorable impact in revenues, as discussed above.

Sales Results

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The following table sets forth individual life insurance annualized new business premiums, as defined under "—Results of Operations—Segment Measures" above, by distribution channel and product, for the periods indicated.

| | 2018 | | | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Prudential Advisors | Third Party | Total | Prudential Advisors | Third Party | Total | Prudential Advisors | Third Party | Total |
| | (in millions) | | | | | | | | |
| Term Life | $28 | $185 | $213 | $30 | $183 | $213 | $32 | $168 | $200 |
| Guaranteed Universal Life(1) | 8 | 89 | 97 | 16 | 140 | 156 | 24 | 219 | 243 |
| Other Universal Life(1) | 45 | 105 | 150 | 37 | 88 | 125 | 34 | 61 | 95 |
| Variable Life | 54 | 109 | 163 | 35 | 95 | 130 | 26 | 66 | 92 |
| Total | $135 | $488 | $623 | $118 | $506 | $624 | $116 | $514 | $630 |

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(1) Single pay life premiums and excess (unscheduled) premiums are included in annualized new business premiums based on a 10% credit and represented approximately 7%, 15% and 13% of Guaranteed Universal Life and 0%, 1% and 3% of Other Universal Life annualized new business premiums for the years ended December 31, 2018, 2017 and 2016, respectively.

2018 to 2017 Annual Comparison. Total annualized new business premiums were in line with the prior year as lower guaranteed universal life sales were offset by higher sales of variable life and other universal life products, as a result of certain distribution, product design and pricing actions implemented to enhance product mix diversification and in response to the adoption in 2017 of the principle-based reserving method for new guaranteed universal life products.

2017 to 2016 Annual Comparison. Total annualized new business premiums decreased $6 million, primarily driven by lower guaranteed universal life sales, partially offset by higher sales across other products, as a result of certain distribution and product actions implemented to enhance product mix diversification.

International Insurance Division

International Insurance

Business Update

We regularly review our existing international businesses and may seek to deploy capital in support of our strategy or to exit an operation if it is determined that it no longer aligns with our broader international strategy.

- In June 2018, we entered into a definitive agreement to sell our Pramerica of Italy subsidiary, subject to regulatory approvals and customary closing conditions. In February 2019, the agreement was terminated and we continue to explore strategic alternatives. The results of this business and the impact of an anticipated sale are reflected in our Corporate and Other operations (see "—Results of Operations by Segment—Divested and Run-off Businesses—Divested and Run-off Businesses Included in Corporate and Other" for additional information).

- In January 2018, we entered into a definitive agreement to sell our Pramerica of Poland subsidiary. This transaction closed in October 2018 and resulted in a gain that was reflected in our Corporate and Other operations (see "—Results of Operations by Segment—Divested and Run-off Businesses—Divested and Run-off Businesses Included in Corporate and Other" for additional information).

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 in "—Results of Operations—Impact of Foreign Currency Exchange Rates" 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 111 yen per U.S. dollar and Korean won at a rate of 1150 won per U.S. dollar, both of which were determined in connection with the foreign currency income hedging program discussed in "—Results of Operations—Impact of Foreign Currency Exchange Rates" 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.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | (in millions) | | |
| Operating results: | | | |
| Revenues: | | | |
| Life Planner operations | $11,176 | $10,644 | $9,986 |
| Gibraltar Life and Other operations | 11,058 | 10,916 | 11,023 |
| Total revenues | 22,234 | 21,560 | 21,009 |
| Benefits and expenses: | | | |
| Life Planner operations | 9,586 | 9,151 | 8,447 |
| Gibraltar Life and Other operations | 9,382 | 9,211 | 9,445 |
| Total benefits and expenses | 18,968 | 18,362 | 17,892 |
| Adjusted operating income: | | | |
| Life Planner operations | 1,590 | 1,493 | 1,539 |
| Gibraltar Life and Other operations | 1,676 | 1,705 | 1,578 |
| Total adjusted operating income | 3,266 | 3,198 | 3,117 |
| Realized investment gains (losses), net, and related adjustments | 172 | 985 | 992 |
| Related charges | 10 | (18) | (32) |
| Investment gains (losses) on assets supporting experience-rated contractholder liabilities, net | (275) | 218 | 4 |
| Change in experience-rated contractholder liabilities due to asset value changes | 275 | (218) | (4) |
| Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests | (69) | (43) | (47) |
| Income (loss) before income taxes and equity in earnings of operating joint ventures | $3,379 | $4,122 | $4,030 |

Adjusted Operating Income

2018 to 2017 Annual Comparison. Adjusted operating income from our Life Planner operations increased $97 million including a net favorable impact of $4 million from currency fluctuations, inclusive of the currency hedging program discussed above. Both periods also include the impact of our annual reviews and update of assumptions and other refinements, which resulted in a $49 million net charge in 2018 compared to a $67 million net charge in 2017. The net charge in both 2018 and 2017 was primarily driven by the impact from unfavorable economic assumption updates driven by a lower long-term interest rate assumption in Japan.

Excluding the effect of these items, adjusted operating income from our Life Planner operations increased $75 million, primarily reflecting the growth of business in force in our Japan, Korea and Brazil operations, and lower expenses, including lower legal costs. These increases were partially offset by an unfavorable impact from mortality experience and a lower contribution from net investment results, driven by the impact of lower reinvestment rates, lower income on non-coupon investments and lower prepayment fee income, partially offset by higher average invested assets resulting from continued business growth.

Adjusted operating income from our Gibraltar Life and Other operations decreased $29 million including a net favorable impact of $4 million from currency fluctuations, inclusive of the currency hedging program discussed above. Both periods also include the impact of our annual reviews and update of assumptions and other refinements, which resulted in a $32 million net charge in 2018 compared to a $21 million net benefit in 2017.

Excluding the effect of these items, adjusted operating income from our Gibraltar Life and Other operations increased $20 million, primarily reflecting the growth of business in force, driven by sales of U.S. dollar-denominated products, and a favorable impact from mortality experience. These increases were partially offset by a lower contribution from net investment results driven by the impact of lower income on non-coupon investments, lower prepayment fee income and lower reinvestment rates, partially offset by higher average invested assets resulting from continued business growth. These net increases were also partially offset by higher expenses, including expenses related to business growth initiatives.

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2017 to 2016 Annual Comparison. Adjusted operating income from our Life Planner operations decreased $46 million including a net unfavorable impact of $39 million from currency fluctuations, inclusive of the currency hedging program discussed above. Both periods also include the impact of our annual reviews and update of assumptions and other refinements, which resulted in a $67 million net charge in 2017, including impacts from unfavorable economic assumption updates driven by a lower long-term interest rate assumption in Japan, compared to a $38 million net charge in 2016.

Excluding the effect of these items, adjusted operating income from our Life Planner operations increased $22 million, primarily reflecting the growth of business in force in our Japan and Brazil operations, improved policyholder experience, and a higher contribution from net investment results, primarily from higher income on non-coupon investments and higher net prepayment fee income, partially offset by lower reinvestment rates. These favorable impacts were partially offset by higher expenses, including legal costs and expenses supporting business growth.

Adjusted operating income from our Gibraltar Life and Other operations increased $127 million including a net favorable impact of $2 million from currency fluctuations, inclusive of the currency hedging program discussed above. Both periods also include the impact of our annual reviews and update of assumptions and other refinements, which resulted in a $21 million net benefit in 2017 compared to a $34 million net charge in 2016.

Excluding the effect of these items, adjusted operating income from our Gibraltar Life and Other operations increased $70 million, primarily reflecting the growth of business in force, including higher earnings from our indirect investment in Administradora de Fondos de Pensiones Habitat S.A. which reflected twelve months of income in 2017 compared to ten months of income in 2016, improved policyholder experience and more favorable comparative mortality experience. These favorable impacts were partially offset by the absence of a gain on the sale of a home office property in Japan in 2016.

Revenues, Benefits and Expenses

2018 to 2017 Annual Comparison. Revenues from our Life Planner operations increased $532 million including a net favorable impact of $6 million from currency fluctuations and a comparatively favorable net impact of $3 million from our annual reviews and update of assumptions and other refinements. Excluding these items, revenues increased $523 million, primarily driven by higher premiums and policy charges and fee income related to the growth of business in force.

Benefits and expenses from our Life Planner operations increased $435 million including a net unfavorable impact of $2 million from currency fluctuations and a comparatively favorable net impact of $15 million from our annual reviews and update of assumptions and other refinements. Excluding these items, benefits and expenses increased $448 million. This increase primarily reflects higher policyholders’ benefits, including changes in reserves, driven by business growth, and an unfavorable impact from mortality experience, partially offset by lower general and administrative expenses, net of capitalization, including lower legal costs.

Revenues from our Gibraltar Life and Other operations increased $142 million, including a net favorable impact of $83 million from currency fluctuations and a comparatively unfavorable net impact of $13 million from our annual reviews and update of assumptions and other refinements. Excluding these items, revenues increased $72 million primarily driven by the growth of business in force.

Benefits and expenses from our Gibraltar Life and Other operations increased $171 million including a net unfavorable impact of $79 million from currency fluctuations and a comparatively unfavorable net impact of $40 million from our annual reviews and update of assumptions and other refinements. Excluding these items, benefits and expenses increased $52 million, primarily driven by higher general and administrative expenses, net of capitalization,

including expenses related to business growth initiatives, partially offset by a decrease in policyholders' benefits, including changes in reserves, related to a favorable impact from mortality experience.

2017 to 2016 Annual Comparison. Revenues from our Life Planner operations increased $658 million including a net unfavorable impact of $60 million from currency fluctuations and a comparatively favorable net impact of $15 million from our annual reviews and update of assumptions and other refinements. Excluding these items, revenues increased $703 million. This increase was primarily driven by higher premiums and policy charges and fee income related to growth of business in force and higher net investment income primarily reflecting higher income on non-coupon investments and higher net prepayment fee income, partially offset by lower reinvestment rates.

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Benefits and expenses from our Life Planner operations increased $704 million including a net favorable impact of $21 million from currency fluctuations and a comparatively unfavorable net impact of $44 million from our annual reviews and update of assumptions and other refinements. Excluding these items, benefits and expenses increased $681 million. This increase primarily reflects higher policyholder benefits, including changes in reserves, driven by business growth, and higher general and administrative expenses, net of capitalization, driven by higher operating expenses, including legal costs and expenses supporting business growth.

Revenues from our Gibraltar Life and Other operations decreased $107 million, including a net unfavorable impact of $153 million from currency fluctuations and a comparatively favorable net impact of $13 million from our annual reviews and update of assumptions and other refinements. Excluding these items, revenues increased $33 million. This increase was primarily driven by higher premiums and policy charges and fee income related to the growth of business in force and higher net investment income.

Benefits and expenses from our Gibraltar Life and Other operations decreased $234 million including a net favorable impact of $155 million from currency fluctuations and a comparatively favorable net impact of $42 million from our annual reviews and update of assumptions and other refinements. Excluding these items, benefits and expenses decreased $37 million, driven by a decrease in policyholder benefits, including changes in reserves, related to improved policyholder experience and more favorable comparative mortality experience.

Sales Results

The following table sets forth annualized new business premiums, as defined under "—Results of Operations—Segment Measures" above, on an actual and constant exchange rate basis for the periods indicated.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | (in millions) | | |
| Annualized new business premiums: | | | |
| On an actual exchange rate basis: | | | |
| Life Planner operations | $1,257 | $1,391 | $1,276 |
| Gibraltar Life(1) | 1,483 | 1,595 | 1,726 |
| Total(1) | $2,740 | $2,986 | $3,002 |
| On a constant exchange rate basis: | | | |
| Life Planner operations | 1,250 | 1,373 | 1,262 |
| Gibraltar Life(1) | 1,481 | 1,599 | 1,710 |
| Total(1) | $2,731 | $2,972 | $2,972 |

(1) Amounts are presented on a consistent basis reflecting the elimination of the one-month reporting lag for Gibraltar Life and Other operations.

The amount of annualized new business premiums and the sales mix in terms of types and currency denomination of products for any given period can be significantly impacted by several factors, including but not limited to: the addition of new products, discontinuation of existing products, changes in credited interest rates for certain products and other product modifications, changes in premium rates, changes in interest rates or fluctuations in currency markets, changes in tax laws, changes in life insurance regulations or changes in the competitive environment. Sales volume may increase or decrease prior to certain of these changes becoming effective, and then fluctuate in the other direction following such changes.

Our diverse product portfolio in Japan, in terms of currency mix and premium payment structure, allows us to adapt to changing market and competitive dynamics, including the extremely low interest rate environment. We regularly examine our product offerings and their related profitability and, as a result, we have repriced or discontinued sales of certain products that do not meet our profit expectations. The impact of these actions, coupled with the introduction of certain new products, has generally resulted in an increase in sales of products denominated in U.S. dollars relative to products denominated in other currencies.

2018 to 2017 Annual Comparison. The table below presents annualized new business premiums on a constant exchange rate basis, by product category and distribution channel, for the periods indicated.

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| | Year Ended December 31, 2018 | | | | | Year Ended December 31, 2017 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Life | Accident & Health | Retirement (1) | Annuity | Total | Life | Accident & Health | Retirement (1) | Annuity | Total |
| | (in millions) | | | | | | | | | |
| Life Planner | $699 | $ 118 | $ 344 | $ 89 | $1,250 | $812 | $ 122 | $ 353 | $ 86 | $1,373 |
| Gibraltar Life(2): | | | | | | | | | | |
| Life Consultants | 308 | 44 | 101 | 329 | 782 | 369 | 50 | 113 | 211 | 743 |
| Banks | 412 | 1 | 29 | 38 | 480 | 525 | 1 | 31 | 58 | 615 |
| Independent Agency | 113 | 10 | 62 | 34 | 219 | 134 | 19 | 66 | 22 | 241 |
| Subtotal(2) | 833 | 55 | 192 | 401 | 1,481 | 1,028 | 70 | 210 | 291 | 1,599 |
| Total | $1,532 | $ 173 | $ 536 | $ 490 | $2,731 | $1,840 | $ 192 | $ 563 | $ 377 | $2,972 |

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(1) Includes retirement income, endowment and savings variable universal life.

(2) Amounts are presented on a consistent basis reflecting the elimination of the one-month reporting lag for Gibraltar Life and Other operations.

Annualized new business premiums, on a constant exchange rate basis, from our Life Planner operations decreased $123 million, primarily reflecting sales in our Japan operations in the prior year period in advance of premium rate increases on yen-based products in the second quarter of 2017 and lower sales of these yen-based products post repricing. The decrease was partially offset by higher sales of U.S. dollar-denominated products in our Japan operations.

Annualized new business premiums, on a constant exchange rate basis, from our Gibraltar Life operations decreased $118 million. Life Consultants sales increased $39 million, primarily reflecting higher sales of U.S. dollar-denominated annuity products and U.S. dollar-denominated life products. The increase was partially offset by lower sales of yen-denominated life products after the second quarter of 2017 repricing discussed above. Bank channel sales decreased $135 million, primarily from lower sales of U.S. dollar-denominated life products due to increased competition in recurring pay life products and the discontinuation of a single pay life product in the fourth quarter of 2017. Independent Agency sales decreased $22 million, primarily reflecting lower sales of yen-denominated life products after the second quarter of 2017 repricing discussed above and increased competition, partially offset by higher sales of U.S. dollar-denominated life and annuity products.

2017 to 2016 Annual Comparison. The table below presents annualized new business premiums on a constant exchange rate basis, by product and distribution channel, for the periods indicated.

| | Year Ended December 31, 2017 | | | | | Year Ended December 31, 2016 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Life | Accident & Health | Retirement (1) | Annuity | Total | Life | Accident & Health | Retirement (1) | Annuity | Total |
| | (in millions) | | | | | | | | | |
| Life Planner | $812 | $ 122 | $ 353 | $ 86 | 1,373 | $741 | $ 115 | $ 331 | $ 75 | 1,262 |
| Gibraltar Life(2): | | | | | | | | | | |
| Life Consultants | 369 | 50 | 113 | 211 | 743 | 354 | 53 | 118 | 211 | 736 |
| Banks | 525 | 1 | 31 | 58 | 615 | 518 | 1 | 67 | 130 | 716 |
| Independent Agency | 134 | 19 | 66 | 22 | 241 | 128 | 21 | 72 | 37 | 258 |
| Subtotal(2) | 1,028 | 70 | 210 | 291 | 1,599 | 1,000 | 75 | 257 | 378 | 1,710 |

| Total | $1,840 | $ 192 | $ 563 | $ 377 | $2,972 | $1,741 | $ 190 | $ 588 | $ 453 | $2,972 |
|---|---|---|---|---|---|---|---|---|---|---|

(1) Includes retirement income, endowment and savings variable universal life.
(2) Amounts are presented on a consistent basis reflecting the elimination of the one-month reporting lag for Gibraltar Life and Other operations.

Annualized new business premiums, on a constant exchange rate basis, from our Life Planner operations increased $111 million. Growth in Life Planner headcount in our Japan operation resulted in an increase in U.S. dollar-denominated whole life and retirement products and yen-denominated term life and retirement products. The increase also reflected higher sales in our Brazil operations across various product lines as Life Planner count continued to grow.

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Annualized new business premiums, on a constant exchange rate basis, from our Gibraltar Life operations decreased $111 million. Life Consultant sales increased $7 million primarily from higher sales of U.S. dollar-denominated whole life products resulting from the introduction of a new recurring pay life product in the second quarter of 2017. This increase was partially offset by lower sales of yen-denominated whole life and term life products. Bank channel sales decreased $101 million primarily from lower sales of yen-denominated term life and whole life products following the premium rate increases on yen-based products in April of 2017, the suspension of sales of yen-denominated annuity products in April 2016 in response to the low interest rate environment and lower sales of U.S. dollar- and Australian dollar-denominated annuity products due to increased competition and product actions. This decrease was partially offset by higher sales of U.S. dollar-denominated whole life products. Independent Agency sales decreased $17 million primarily reflecting lower sales of yen-denominated whole life and term life products after the April 2017 repricing and lower sales of Australian dollar-denominated annuity products. The decrease was partially offset by higher sales of U.S. dollar-denominated whole life products.

Sales Force

The following table sets forth the number of Life Planners and Life Consultants for the periods indicated.

| | As of December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| Life Planners: | | | |
| Japan | 4,183 | 3,941 | 3,824 |
| All other countries | 3,786 | 3,890 | 3,856 |
| Gibraltar Life Consultants | 7,964 | 8,326 | 8,884 |
| Total | 15,933 | 16,157 | 16,564 |

2018 to 2017 Comparison. The number of Life Planners increased by 138, driven by an increase of 242 in Japan as a result of recruiting efforts and fewer terminations. Life Planners decreased by 104 in other operations, primarily as a result of the absence of Life Planners in Italy and Poland (as discussed above under "—Business Update"), partially offset by an increase in Brazil as a result of improved recruiting efforts. The number of Gibraltar Life Consultants decreased by 362, primarily reflecting more selective recruiting efforts and retention standards.

2017 to 2016 Comparison. The number of Life Planners increased by 151, driven by an increase of 117 in Japan as a result of improved recruiting efforts and fewer terminations. Life Planners increased by 34 in other operations, primarily in Brazil as a result of recruiting efforts, partially offset by a decrease in Korea and Taiwan as a result of more selective recruiting efforts and retention standards. The number of Gibraltar Life Consultants decreased by 558, primarily reflecting more selective recruiting efforts and retention standards.

Corporate and Other

Corporate and Other includes corporate operations, after allocations to our business segments, and Divested and Run-off Businesses other than those that qualify for "discontinued operations" accounting treatment under U.S. GAAP.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | (in millions) | | |
| Operating results: | | | |
| Capital debt interest expense | $(726 ) | $(705 ) | $(686 ) |
| Investment income, net of operating debt interest expense | 86 | 96 | 1 |

| | | | |
|---|---|---|---|
| Pension and employee benefits | 195 | 157 | 103 |
| Other corporate activities(1) | (838 ) | (985 ) | (999 ) |
| Adjusted operating income | (1,283 ) | (1,437 ) | (1,581 ) |
| Realized investment gains (losses), net, and related adjustments | 216 | (407 ) | (1,797 ) |
| Related charges | 7 | (26 ) | (1 ) |
| Divested and Run-off Businesses | (1,535 ) | 38 | (84 ) |
| Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests | 4 | (19 ) | (3 ) |
| Income (loss) before income taxes and equity in earnings of operating joint ventures | $(2,591) | $(1,851) | $(3,466) |

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(1) Includes consolidating adjustments.

2018 to 2017 Annual Comparison. The loss from Corporate and Other operations, on an adjusted operating income basis, decreased $154 million. Net charges from other corporate activities decreased $147 million, primarily reflecting lower costs for employee compensation plans tied to Company stock and equity market performance, partially offset by increased expenses, including expenses related to corporate initiatives. Results for investment income, net of operating debt interest expense, decreased $10 million, including lower net investment income driven by transfers of investments in the second quarter of 2018 to support higher capital requirements in the Long-Term Care Run-off business, partially offset by higher income on non-coupon investments and highly liquid assets, and lower operating debt interest expense. Capital debt interest expense increased $21 million, reflecting higher debt balances from debt issuances in the third quarter of 2017 and the first and third quarters of 2018, partially offset by the extinguishment of junior subordinated debt in the second quarter of 2018 and a senior debt maturity in the fourth quarter of 2017.

Results from pension and employee benefits increased $38 million, primarily reflecting higher income from our qualified pension plan, including higher expected earnings on plan assets and lower interest costs on plan obligations driven by a decline in interest rates in 2017.

For purposes of calculating pension income from our qualified pension plan for the year ended December 31, 2019, we will increase the discount rate from 3.65% to 4.30% as of December 31, 2018. The expected rate of return on plan assets will increase from 6.25% in 2018 to 6.50% in 2019. The assumed rate of increase in compensation will remain unchanged at 4.50%. Giving effect to the foregoing assumptions and other factors, we expect income from our qualified pension plan in 2019 to be approximately $50 million to $55 million lower than 2018 levels. The decrease is driven by lower expected returns on plan assets due to lower than expected plan fixed income asset growth in 2018 as well as higher interest costs on the plan obligation due to the higher discount rate.

For purposes of calculating postretirement benefit expenses for the year ended December 31, 2019, we will increase the discount rate from 3.60% to 4.30% as of December 31, 2018. The expected rate of return on plan assets will remain unchanged at 7.00%. Giving effect to the foregoing assumptions and other factors, we expect postretirement benefit expenses in 2019 to be approximately $30 million to $35 million higher than 2018 levels. The increase in expenses is driven by lower expected returns on plan assets due to lower than expected asset growth in 2018, as well as higher interest costs on the plan obligation due to the higher discount rate.

In 2019, pension and other postretirement benefit service costs related to active employees will continue to be allocated to our business segments. For further information regarding our pension and postretirement plans, see Note 17 to the Consolidated Financial Statements.

2017 to 2016 Annual Comparison. The loss from Corporate and Other operations, on an adjusted operating income basis, decreased $144 million. Results for investment income, net of operating debt interest expense, improved $95 million, primarily reflecting lower operating debt interest expense, including efforts in 2016 to reduce leverage through senior debt maturities and early extinguishment of debt, and higher investment income, driven by the absence of a non-coupon investment loss incurred in the prior year and higher income on highly liquid assets. Net charges from other corporate activities decreased $14 million, reflecting the absence of costs incurred in the prior year associated with the early extinguishment of certain debt, partially offset by increases in other corporate expenses, including higher costs for employee compensation plans tied to equity market and Company performance, and increased expenses related to corporate initiatives. Capital debt interest expense increased $19 million, primarily resulting from a junior subordinated debt issuance in the third quarter of 2017.

Results from pension and employee benefits increased $54 million, primarily reflecting higher income from our qualified pension plan, including higher expected earnings on plan assets and lower interest costs on plan obligations driven by a decline in interest rates in 2016.

Capital Protection Framework

"Realized investment gains (losses), net and related adjustments," which are excluded from adjusted operating income, included a net gain of $121 and net losses of $154 million and $1,649 million for the years ended December 31, 2018, 2017 and 2016, respectively, primarily related to impacts of interest rate movements, which are considered within our Capital Protection Framework. The favorable changes in 2018 and 2017 results compared to 2016 are primarily attributed to changes in our Individual Annuities risk management strategy implemented in 2016, whereby we terminated the existing intercompany derivative transactions between Corporate and Other operations and the Individual Annuities business segment related to managing interest rate risk and we now manage this risk within the Individual Annuities business segment. The net loss in 2016, while the intercompany

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derivative transactions between Corporate and Other operations and the Individual Annuities business segment were in place, primarily resulted from our utilization of capital management strategies to manage a portion of our interest rate risk and reflects changes in interest rates with respect to the exposures outstanding in 2016. For more information on our Individual Annuities risk management strategy, see "—Individual Annuities." For more information on our Capital Protection Framework, see "—Liquidity and Capital Resources—Capital Protection Framework."

Divested and Run-off Businesses

Divested and Run-off Businesses Included in Corporate and Other

Income from our Divested and Run-off Businesses includes results from several businesses that have been or will be sold or exited, including businesses that have been placed in wind down status that do not qualify for "discontinued operations" accounting treatment under U.S. GAAP. The results of these Divested and Run-off Businesses are reflected in our Corporate and Other operations, but are excluded from adjusted operating income. A summary of the results of the Divested and Run-off Businesses reflected in our Corporate and Other operations is as follows for the periods indicated:

| | Year ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | (in millions) | | |
| Long-Term Care | $(1,458) | $42 | $(74) |
| Other | (77) | (4) | (10) |
| Total Divested and Run-off Businesses income (loss) excluded from adjusted operating income | $(1,535) | $38 | $(84) |

Long-Term Care. Results for the year ended December 31, 2018 decreased compared to 2017, primarily reflecting unfavorable comparative net impacts from our annual reviews and update of assumptions and other refinements. Results for 2018 include a $1,458 million net charge from these updates including the removal of our assumption of expected future morbidity improvement, reflecting unfavorable morbidity experience relative to prior expectations. Excluding these impacts, results for 2018 decreased compared to 2017, primarily reflecting net realized investment losses in the current period compared to net realized investment gains in the prior year period driven by an unfavorable comparative change in market values of derivatives used for duration management. Also contributing to the decrease was a decline in the market value of investments in equity securities in the current period which, effective January 1, 2018 as a result of ASU 2016-01, are reported in net income as opposed to other comprehensive income. Results for the year ended December 31, 2017 increased compared to 2016 primarily reflecting net realized investment gains in 2017 compared to net realized investment losses in 2016.

Other. Results for the year ended December 31, 2018 decreased in comparison to the prior year period primarily reflecting losses related to an anticipated sale of our Pramerica of Italy subsidiary and the exit of our PGIM Brazil operations, partially offset by a gain related to the sale of our Pramerica of Poland subsidiary (see "—Results of Operations by Segment—International Insurance Division—International Insurance" and "—Results of Operations by Segment—PGIM Division—PGIM" for additional information).

Closed Block Division

The Closed Block division includes certain 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 (collectively, the "Closed Block"), as well as certain related assets and liabilities. We no longer offer these traditional

domestic participating policies. See Note 14 to the Consolidated Financial Statements for additional details.

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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 (losses), 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 division 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 December 31, 2018, the excess of actual cumulative earnings over the expected cumulative earnings was $2,252 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 $899 million at December 31, 2018, to be paid to Closed Block policyholders unless offset by future experience, with a corresponding amount reported in AOCI.

Operating Results

The following table sets forth the Closed Block division's results for the periods indicated.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | (in millions) | | |
| U.S. GAAP results: | | | |
| Revenues | $4,678 | $5,826 | $5,669 |
| Benefits and expenses | 4,740 | 5,781 | 5,801 |
| Income (loss) before income taxes and equity in earnings of operating joint ventures | $(62) | $45 | $(132) |

Income (loss) Before Income Taxes and Equity in Earnings of Operating Joint Ventures

2018 to 2017 Annual Comparison. Income (loss) before income taxes and equity in earnings of operating joint ventures decreased $107 million. Results for 2018 primarily reflected a $554 million decrease in net realized investment gains and related activity, primarily due to a decline in equity investment values and lower gains from sales of fixed maturities, partially offset by favorable changes in the value of derivatives used in risk management activities. Net investment income decreased $365 million, primarily driven by lower income on non-coupon investments, lower reinvestments yields and lower prepayment income. Net insurance activity results increased $144 million, primarily as a result of a decrease in the 2018 dividend scale and runoff of policies in force. As a result of the above and other variances, a $508 million reduction in the policyholder dividend obligation was recorded in 2018, compared to a $143 million increase in 2017. If actual cumulative earnings fall below expected cumulative earnings in future periods, earnings volatility in the Closed Block division, which is primarily due to changes in investment results, may not be offset by changes in the cumulative earnings policyholder dividend obligation. For a discussion of Closed Block division realized investment gains (losses), net, see "—General Account Investments—Realized Investment Gains and Losses."

2017 to 2016 Annual Comparison. Income (loss) before income taxes and equity in earnings of operating joint ventures increased $177 million. Results for 2017 primarily reflected a $175 million increase in net realized investment gains and related activity, primarily due to higher gains from sales of equity securities and fixed maturities, partially offset by unfavorable changes in the value of derivatives used in risk management activities. Net insurance activity results increased $92 million, primarily as a result of a decrease in the 2018 dividend scale, partially offset by the runoff of policies in force and higher benefit payments. Net investment income increased $75 million, primarily driven by higher income on non-coupon investments and higher prepayment income, partially offset by lower reinvestment rates. As a result of the above and other variances, a $143 million increase in the policyholder dividend obligation was recorded in 2017, compared to $48 million reduction in 2016.

Revenues, Benefits and Expenses

2018 to 2017 Annual Comparison. Revenues decreased $1,148 million primarily due to decreases of $404 million in net realized investment gains, $365 million in net investment income and $150 million in other revenue, which are discussed above, as well as a decrease of $225 million in premiums due to run-off of policies in force.

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Benefits and expenses decreased $1,041 million. Dividends to policyholders decreased $771 million reflecting a decrease in the policyholder dividend obligation expense driven by a reduction in the 2018 dividend scale as well as changes in cumulative earnings. Policyholders' benefits, including changes in reserves, decreased $247 million primarily due to the run-off of policies in force, as discussed above.

2017 to 2016 Annual Comparison. Revenues increased $157 million, primarily due to increases of $100 million in net realized investment gains, $75 million in other revenue and $75 million in net investment income, as discussed above. Partially offsetting these increases was a decrease in premiums of $94 million, primarily due to run-off of policies in force.

Benefits and expenses decreased $20 million. Policyholders' benefits, including changes in reserves, decreased $63 million primarily due to the runoff of policies in force, as discussed above. Partially offsetting this decrease was an increase in dividends to policyholders of $66 million, reflecting an increase in the policyholder dividend obligation expense due to changes in cumulative earnings.

Income Taxes

The differences between income taxes expected at the U.S. federal statutory income tax rate of 21% applicable for 2018 and 35% applicable for the periods prior to 2018, and the reported income tax (benefit) expense are provided in the following table:

| | Year Ended December 31, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2018 | | | 2017 | | | 2016 | | |
| | (in millions) | | | | | | | | |
| Expected federal income tax expense (benefit) at federal statutory rate | $ | 1,015 | | $ | 2,270 | | $ | 1,997 | |
| Non-taxable investment income | (246 | | ) | (369 | | ) | (352 | | ) |
| Foreign taxes at other than U.S. rate | 349 | | | (249 | | ) | (172 | | ) |
| Low-income housing and other tax credits | (112 | | ) | (126 | | ) | (118 | | ) |
| Changes in tax law | (321 | | ) | (2,858 | | ) | 0 | | |
| Other | 137 | | | (106 | | ) | (20 | | ) |
| Reported income tax expense (benefit) | $ | 822 | | $ | (1,438 | ) | $ | 1,335 | |
| Effective tax rate | 17.0 | | % | (22.2 | | )% | 23.4 | | % |

Effective Tax Rate

The effective tax rate is the ratio of “Total income tax expense (benefit)” divided by “Income before income taxes and equity in earnings of operating joint ventures.” Our effective tax rate for fiscal years 2018, 2017 and 2016 was 17.0%, (22.2)%, and 23.4%, respectively. For a detailed description of the nature of each significant reconciling item, see Note 15 to the Consolidated Financial Statements. The decrease in the effective tax rate from 23.4% in 2016 to (22.2)% in 2017, and the increase in the effective tax rate from (22.2)% in 2017 to 17.0% in 2018 was primarily driven by the impacts of the Tax Act of 2017.

Unrecognized Tax Benefits

The Company’s liability for income taxes includes the liability for unrecognized tax benefits and interest that relate to tax years still subject to review by the Internal Revenue Service or other taxing authorities. The completion of review or the expiration of the Federal statute of limitations for a given audit period could result in an adjustment to the liability for income taxes. The total unrecognized benefit as of December 31, 2018, 2017 and 2016 was $20 million, $45 million and $26 million, respectively. We do not anticipate any significant changes within the next twelve months to our total unrecognized tax benefits related to tax years for which the statute of limitations has not expired.

Income Tax Expense vs. Income Tax Paid in Cash

Income tax expense recorded under U.S. GAAP routinely differs from the income taxes paid in cash in any given year. Income tax expense recorded under U.S. GAAP is based on income reported in our Consolidated Statements of Operations for the current period and it includes both current and deferred taxes. Income taxes paid during the year include tax installments made for the current year as well as tax payments and refunds related to prior periods.

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For additional information on income tax related items, see "Business—Regulation" and Note 15 to the Consolidated Financial Statements.

Experience-Rated Contractholder Liabilities,
Assets Supporting Experience-Rated Contractholder 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 carried at fair value. These investments are reflected on the Consolidated Statements of Financial Position as "Assets supporting experience-rated contractholder liabilities, at fair value." Realized and unrealized gains (losses) for these investments are reported in "Other income (loss)." 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 Consolidated Statements of Financial Position as "Other invested assets" and are carried at fair value, and the realized and unrealized gains (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 Consolidated Statements of Financial Position as "Commercial mortgage and other loans." Gains (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 assets supporting experience-rated contractholder liabilities 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, primarily classified in the Consolidated Statements of Financial Position as "Policyholders' account balances." 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 (losses) on assets supporting experience-rated contractholder liabilities, related derivatives and commercial mortgage and other loans. This is consistent with the exclusion of realized investment gains (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 (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." 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 table sets forth the impact on results for the periods indicated of these items that are excluded from adjusted operating income:

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| | Year ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | (in millions) | | |
| Retirement Segment: | | | |
| Investment gains (losses) on: | | | |
| Assets supporting experience-rated contractholder liabilities, net | $(588) | $118 | $(21) |
| Derivatives | 103 | (168 ) | (10 ) |
| Commercial mortgages and other loans | 13 | (7 ) | 5 |
| Change in experience-rated contractholder liabilities due to asset value changes(1)(2) | 435 | 67 | 25 |
| Net gains (losses) | $(37 ) | $10 | $(1 ) |
| International Insurance Segment: | | | |
| Investment gains (losses) on assets supporting experience-rated contractholder liabilities, net | $(275) | $218 | $4 |
| Change in experience-rated contractholder liabilities due to asset value changes | 275 | (218 ) | (4 ) |
| Net gains (losses) | $0 | $0 | $0 |
| Total: | | | |
| Investment gains (losses) on: | | | |
| Assets supporting experience-rated contractholder liabilities, net | $(863) | $336 | $(17) |
| Derivatives | 103 | (168 ) | (10 ) |
| Commercial mortgages and other loans | 13 | (7 ) | 5 |
| Change in experience-rated contractholder liabilities due to asset value changes(1)(2) | 710 | (151 ) | 21 |
| Net gains (losses) | $(37 ) | $10 | $(1 ) |

(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 $99 million, $18 million and $10 million as of December 31, 2018, 2017 and 2016, 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 a decrease of $23 million, a decrease of $21 million and an increase of $4 million for the years ended December 31, 2018, 2017 and 2016, 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.

The net impacts, for the Retirement segment, of changes in experience-rated contractholder liabilities and investment gains (losses) on assets supporting experience-rated contractholder liabilities and other related investments 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 mortgages and other loans and the amortized cost, less any valuation allowance, of these loans, as described above.

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 significant unobservable input in the measurement. See Note 6 to the Consolidated Financial Statements for an additional description of the valuation hierarchy levels as well as for the balances of assets and liabilities measured at fair value on a recurring basis by hierarchy level presented on a consolidated basis.

The table below presents the balances of assets and liabilities measured at fair value on a recurring basis, as of the periods indicated, and the portion of such assets and liabilities that are classified in Level 3 of the valuation hierarchy. The table also provides details about these assets and liabilities excluding those held in the Closed Block division. We believe the amounts excluding the Closed Block division are most relevant to an understanding of our operations that are pertinent to investors in Prudential Financial because substantially all Closed Block division assets support obligations and liabilities relating to the Closed Block policies only. See Note 14 to the Consolidated Financial Statements for further information on the Closed Block.

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| | As of December 31, 2018 | | | | As of December 31, 2017 | | | |
|---|---|---|---|---|---|---|---|---|
| | PFI excluding Closed Block Division | | Closed Block Division | | PFI excluding Closed Block Division | | Closed Block Division | |
| | 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 | $314,911 | $ 3,455 | $38,745 | $ 780 | $305,518 | $ 7,557 | $41,262 | $ 2,139 |
| Assets supporting experience-rated contractholder liabilities: | | | | | | | | |
| Fixed maturities | 19,579 | 818 | 0 | 0 | 20,209 | 1,408 | 0 | 0 |
| Equity securities | 1,460 | 1 | 0 | 0 | 1,643 | 4 | 0 | 0 |
| All other(2) | 215 | 0 | 0 | 0 | 137 | 7 | 0 | 0 |
| Subtotal | 21,254 | 819 | 0 | 0 | 21,989 | 1,419 | 0 | 0 |
| Fixed maturities, trading | 3,048 | 204 | 195 | 2 | 3,307 | 155 | 200 | 1 |
| Equity securities | 4,316 | 604 | 1,784 | 67 | 4,855 | 712 | 2,479 | 83 |
| Commercial mortgage and other loans | 763 | 0 | 0 | 0 | 593 | 0 | 0 | 0 |
| Other invested assets(3) | 1,404 | 263 | 5 | 0 | 1,330 | 137 | 2 | 0 |
| Short-term investments | 5,040 | 65 | 453 | 24 | 5,351 | 8 | 436 | 0 |
| Cash equivalents | 9,027 | 59 | 451 | 18 | 7,722 | 0 | 577 | 0 |
| Other assets | 25 | 25 | 0 | 0 | 14 | 13 | 0 | 0 |
| Separate account assets | 254,066 | 1,534 | 0 | 0 | 280,393 | 2,122 | 0 | 0 |
| Total assets | $613,854 | $ 7,028 | $41,633 | $ 891 | $631,072 | $ 12,123 | $44,956 | $ 2,223 |
| Future policy benefits | $8,926 | $ 8,926 | $0 | $ 0 | $8,720 | $ 8,720 | $0 | $ 0 |
| Other liabilities(3) | 191 | 56 | 0 | 0 | 688 | 50 | 0 | 0 |
| Notes issued by consolidated variable interest entities ("VIEs") | 595 | 595 | 0 | 0 | 1,196 | 1,196 | 0 | 0 |
| Total liabilities | $9,712 | $ 9,577 | $0 | $ 0 | $10,604 | $ 9,966 | $0 | $ 0 |

(1) Level 3 assets expressed as a percentage of total assets measured at fair value on a recurring basis for PFI excluding the Closed Block division and for the Closed Block division totaled 1.1% and 2.1%, respectively, as of December 31, 2018 and 1.9% and 4.9%, respectively, as of December 31, 2017.
(2) "All other" represents cash equivalents and short-term investments.
(3) "Other invested assets" and "Other liabilities" primarily include derivatives. The amounts include the impact of netting subject to master netting agreements.

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 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 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 internal valuation models use significant unobservable inputs and, accordingly, such securities are included in

Level 3 in our fair value hierarchy. Level 3 fixed maturity securities for PFI excluding the Closed Block division included approximately $1.9 billion of public fixed maturities as of December 31, 2018 with values primarily based on indicative broker quotes, and approximately $2.5 billion of private fixed maturities, with values primarily based on internally-developed models. Significant unobservable inputs used included: issue specific spread 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 have access to this data.

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The Company's determination to classify assets and liabilities within Level 3 is based on significance of the unobservable inputs in the overall fair value measurement. Periodically, transfers between levels are made to reflect changes in observability of inputs and market activity. During the second quarter of 2018, $5,078 million of investments in CLOs reported as "Asset-backed securities" were transferred from Level 3 to Level 2 as market activity, liquidity and overall observability of valuation inputs of CLOs has increased. All transfers are generally reported at the value as of the beginning of the quarter in which transfers occur for any such assets still held at the end of the quarter.

The impact that fair value changes of fixed maturity securities (and equity securities prior to January 1, 2018) have on the results of operations is dependent on the classification of the security as trading, available-for-sale, or held-to-maturity. For investments classified as trading, changes in fair value are recorded within "Other income (loss)." For investments classified as available-for-sale, changes in fair value are recorded as an unrealized gain or loss in AOCI, a separate component of equity. Investments classified as held-to-maturity are carried at amortized cost and the changes in fair value have no impact on the results of operations. Effective January 1, 2018, as a result of the adoption of ASU 2016-01 (see Note 2), the classifications above no longer apply to equity securities and changes in fair value are recorded within "Other income (loss)."

Separate Account Assets

Separate account assets included in Level 3 primarily include corporate securities and commercial mortgage loans. The valuation of corporate securities is determined as described above for fixed maturity and equity securities. See Note 6 to the Consolidated Financial Statements for additional information on the valuation of commercial mortgage loans. Separate account liabilities are reported at contract value and not at fair value.

Variable Annuity Living Benefit Features

Future policy benefits classified in Level 3 primarily include liabilities related to guarantees associated with the living benefit features of certain variable annuity contracts offered by our Individual Annuities segment, including GMAB, GMWB and 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 future rider fees attributable to the embedded derivative feature. This methodology could result in either a liability or contra-liability balance, based on 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. Future policy benefits classified as Level 3 for PFI excluding the Closed Block division were a net liability of $8.9 billion as of December 31, 2018. For additional information, see "—Results of Operations by Segment—U.S. Individual Solutions Division—Individual Annuities."

Notes Issued by Consolidated VIEs

As discussed in Note 4 to the Consolidated Financial Statements, notes issued by consolidated VIEs represent non-recourse notes issued by certain asset-backed investment vehicles, primarily CLOs, which we are required to consolidate. We have elected the fair value option for these notes, which are valued based on corresponding bank loan collateral.

For additional information about the key estimates and assumptions used in our determination of fair value, see Note 6 to the Consolidated Financial Statements.

General Account Investments

We maintain diversified investment portfolios in our general account to support our liabilities to customers as well as our other general liabilities. Investments and other assets that do not support general account liabilities, and are therefore excluded from our general account, are as follows:

- assets of our derivative operations;
- assets of our investment management operations, including investments managed for third-parties; and
- those assets classified as “Separate account assets” on our balance sheet.

The general account portfolios are managed pursuant to the distinct objectives and investment policy statements of PFI excluding the Closed Block division and of the Closed Block division. The primary investment objectives of PFI excluding the Closed Block division include:

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- hedging and otherwise managing the market risk characteristics of the major product liabilities and other obligations of the Company;
- optimizing investment income yield within risk constraints over time; and
- for certain portfolios, optimizing total return, including both investment income yield and capital appreciation, within risk constraints over time, while managing the market risk exposures associated with the corresponding product liabilities.

We pursue our objective to optimize investment income yield for PFI excluding the Closed Block division over time through:

- the investment of net operating cash flows, including new product premium inflows, and proceeds from investment sales, repayments and prepayments into investments with attractive risk-adjusted yields; and
- the sale of investments, where appropriate, either to meet various cash flow needs or to manage the portfolio's risk exposure profile with respect to duration, credit, currency and other risk factors, while considering the impact on taxes and capital.

The primary investment objectives of the Closed Block division include:

- providing for the reasonable dividend expectations of the participating policyholders within the Closed Block division; and
- optimizing total return, including both investment income yield and capital appreciation, within risk constraints, while managing the market risk exposures associated with the major products in the Closed Block division.

Our portfolio management approach, while emphasizing our investment income yield and asset/liability risk management objectives, also takes into account the capital and tax implications of portfolio activity and our assertions regarding our ability and intent to hold debt securities to recovery. For a further discussion of our OTTI policies, including our assertions regarding any intention or requirement to sell debt securities before anticipated recovery, see "—Realized Investment Gains and Losses—Impairments" below.

Management of Investments

The Investment Committee of our Board of Directors ("Board") oversees our proprietary investments, including our general account portfolios, and regularly reviews performance and risk positions. Our Chief Investment Officer Organization ("CIO Organization") develops investment policies subject to risk limits proposed by our Enterprise Risk Management ("ERM") group for the general account portfolios of our domestic and international insurance subsidiaries and directs and oversees management of the general account portfolios within risk limits and exposure ranges approved annually by the Investment Committee.

The CIO Organization, including related functions within our insurance subsidiaries, works closely with product actuaries and ERM to understand the characteristics of our products and their associated market risk exposures. This information is incorporated into the development of target asset portfolios that manage market risk exposures associated with the liability characteristics and establish investment risk exposures, within tolerances prescribed by Prudential's investment risk limits, on which we expect to earn an attractive risk-adjusted return. We develop asset strategies for specific classes of product liabilities and attributed or accumulated surplus, each with distinct risk characteristics. Market risk exposures associated with the liabilities include interest rate risk, which is addressed through the duration characteristics of the target asset mix, and currency risk, which is addressed by the currency profile of the target asset mix. In certain of our smaller markets outside of the U.S. and Japan, capital markets limitations hinder our ability to hedge interest rate exposure to the same extent we do for our U.S. and Japan businesses and lead us to accept a higher degree of interest rate risk in these smaller portfolios. General account

portfolios typically include allocations to credit and other investment risks as a means to enhance investment yields and returns over time.

Most of our products can be categorized into the following three classes:

- interest-crediting products for which the rates credited to customers are periodically adjusted to reflect market and competitive forces and actual investment experience, such as fixed annuities and universal life insurance;
- participating individual and experience-rated group products in which customers participate in actual investment and business results through annual dividends, interest or return of premium; and
- products with fixed or guaranteed terms, such as traditional whole life and endowment products, guaranteed investment contracts ("GICs"), funding agreements and payout annuities.

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Our total investment portfolio is composed of a number of operating portfolios. Each operating portfolio backs a specific set of liabilities, and the portfolios have a target asset mix that supports the liability characteristics, including duration, cash flow, liquidity needs and other criteria. As of December 31, 2018, the average duration of our domestic general account investment portfolios attributable to PFI excluding the Closed Block division, including the impact of derivatives, was between 6 and 7 years. As of December 31, 2018, the average duration of our international general account portfolios attributable to our Japanese insurance operations, including the impact of derivatives, was between 11 and 12 years and represented a blend of yen-denominated and U.S. dollar and Australian dollar-denominated investments, which have distinct average durations supporting the insurance liabilities we have issued in those currencies. Our asset/liability management process has enabled us to manage our portfolios through several market cycles.

We implement our portfolio strategies primarily through investment in a broad range of fixed income assets, including government and agency securities, public and private corporate bonds and structured securities and commercial mortgage loans. In addition, we hold allocations of non-coupon investments, which include equity securities and other invested assets such as LPs/LLCs, real estate held through direct ownership, derivative instruments, and seed money investments in separate accounts.

We manage our public fixed maturity portfolio to a risk profile directed or overseen by the CIO Organization and ERM groups and to a profile that also reflects the market environments impacting both our domestic and international insurance portfolios. The return that we earn on the portfolio will be reflected in investment income and in realized gains or losses on investments.

We use privately-placed corporate debt securities and commercial mortgage loans, which consist of mortgages on diversified properties in terms of geography, property type and borrowers, to enhance the yield on our portfolio and to improve the overall diversification of the portfolios. Private placements typically offer enhanced yields due to an illiquidity premium and generally offer enhanced credit protection in the form of covenants. 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.

Derivative strategies are employed in the context of our risk management framework to enhance our ability to manage interest rate and currency risk exposures of the asset portfolio relative to the liabilities and to manage credit and equity positions in the investment portfolios. For a discussion of our risk management process, see “Quantitative and Qualitative Disclosures About Market Risk” below.

Our portfolio asset allocation reflects our emphasis on diversification across asset classes, sectors and issuers. The CIO Organization, directly and through related functions within the insurance subsidiaries, implements portfolio strategies primarily through various investment management units within Prudential’s PGIM segment. Activities of the PGIM segment on behalf of the general account portfolios are directed and overseen by the CIO Organization and monitored by ERM for compliance with investment risk limits.

Portfolio Composition

Our investment portfolio consists of public and private fixed maturity securities, commercial mortgage and other loans, policy loans and non-coupon investments as defined above. 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 PGIM segment. The size of our portfolio enables us to invest in asset classes that may be unavailable to the typical investor.

Effective January 1, 2018, the Company adopted ASU 2016-01, Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Liabilities which impacted the Company's accounting and presentation related to equity investments. For additional details regarding the adoption of ASU 2016-01, see Note 2 to the Consolidated Financial Statements.

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The following tables set forth the composition of the investments of our general account apportioned between PFI excluding the Closed Block division and the Closed Block division, as of the dates indicated:

| | December 31, 2018 | | | |
|---|---|---|---|---|
| | PFI Excluding Closed Block Division | | Closed Block Division | Total |
| | ($ in millions) | | | |
| Fixed maturities: | | | | |
| Public, available-for-sale, at fair value | $269,109 | 64.8 % | $ 26,203 | $295,312 |
| Public, held-to-maturity, at amortized cost | 1,745 | 0.4 | 0 | 1,745 |
| Private, available-for-sale, at fair value | 45,328 | 10.9 | 12,542 | 57,870 |
| Private, held-to-maturity, at amortized cost | 268 | 0.1 | 0 | 268 |
| Fixed maturities, trading, at fair value | 1,893 | 0.5 | 195 | 2,088 |
| Assets supporting experience-rated contractholder liabilities, at fair value | 21,254 | 5.1 | 0 | 21,254 |
| Equity securities, at fair value | 3,849 | 0.9 | 1,784 | 5,633 |
| Commercial mortgage and other loans, at book value | 50,251 | 12.1 | 8,782 | 59,033 |
| Policy loans, at outstanding balance | 7,606 | 1.8 | 4,410 | 12,016 |
| Other invested assets(1) | 8,407 | 2.0 | 3,316 | 11,723 |
| Short-term investments | 5,948 | 1.4 | 478 | 6,426 |
| Total general account investments | 415,658 | 100.0% | 57,710 | 473,368 |
| Invested assets of other entities and operations(2) | 5,877 | | 0 | 5,877 |
| Total investments | $421,535 | | $ 57,710 | $479,245 |

| | December 31, 2017 | | | |
|---|---|---|---|---|
| | PFI Excluding Closed Block Division | | Closed Block Division | Total |
| | ($ in millions) | | | |
| Fixed maturities: | | | | |
| Public, available-for-sale, at fair value | $260,430 | 64.7 % | $ 27,448 | $287,878 |
| Public, held-to-maturity, at amortized cost | 1,747 | 0.4 | 0 | 1,747 |
| Private, available-for-sale, at fair value | 44,479 | 11.1 | 13,814 | 58,293 |
| Private, held-to-maturity, at amortized cost | 302 | 0.1 | 0 | 302 |
| Fixed maturities, trading, at fair value | 1,589 | 0.4 | 200 | 1,789 |
| Assets supporting experience-rated contractholder liabilities, at fair value | 22,097 | 5.5 | 0 | 22,097 |
| Equity securities, at fair value | 4,276 | 1.1 | 2,479 | 6,755 |
| Commercial mortgage and other loans, at book value | 46,394 | 11.5 | 9,017 | 55,411 |
| Policy loans, at outstanding balance | 7,348 | 1.8 | 4,543 | 11,891 |
| Other invested assets(1) | 7,510 | 1.9 | 3,159 | 10,669 |
| Short-term investments | 6,103 | 1.5 | 631 | 6,734 |
| Total general account investments | 402,275 | 100.0% | 61,291 | 463,566 |
| Invested assets of other entities and operations(2) | 6,305 | | 0 | 6,305 |
| Total investments(3) | $408,580 | | $ 61,291 | $469,871 |

(1) Other invested assets consist of investments in LPs/LLCs, investment real estate held through direct ownership, derivative instruments and other miscellaneous investments. For additional information regarding these investments, see "—Other Invested Assets" below.

(2) Includes invested assets of our investment management and derivative operations. Excludes assets of our investment management operations that are 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.

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

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The increase in general account investments attributable to PFI excluding the Closed Block division in 2018 was primarily due to the reinvestment of net investment income and net business inflows, partially offset by an increase in U.S. interest rates and credit spread widening. For information regarding the methodology used in determining the fair value of our fixed maturities, see Note 6 to the Consolidated Financial Statements.

As of December 31, 2018 and 2017, 43% and 42%, respectively, of our general account investments attributable to PFI excluding the Closed Block division related to our Japanese insurance operations. The following table sets forth the composition of the investments of our Japanese insurance operations' general account, as of the dates indicated:

| | December 31, | |
|---|---|---|
| | 2018 | 2017 |
| | (in millions) | |
| Fixed maturities: | | |
| Public, available-for-sale, at fair value | $133,084 | $128,332 |
| Public, held-to-maturity, at amortized cost | 1,745 | 1,747 |
| Private, available-for-sale, at fair value | 16,222 | 14,538 |
| Private, held-to-maturity, at amortized cost | 268 | 302 |
| Fixed maturities, trading, at fair value | 328 | 257 |
| Assets supporting experience-rated contractholder liabilities, at fair value | 2,441 | 2,586 |
| Equity securities, at fair value | 1,972 | 2,151 |
| Commercial mortgage and other loans, at book value | 17,228 | 14,268 |
| Policy loans, at outstanding balance | 2,715 | 2,545 |
| Other invested assets(1) | 1,957 | 2,021 |
| Short-term investments | 451 | 244 |
| Total Japanese general account investments(2) | $178,411 | $168,991 |

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(1) Other invested assets consist of investments in LPs/LLCs, investment real estate held through direct ownership, derivative instruments and other miscellaneous investments.

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

The increase in general account investments related to our Japanese insurance operations in 2018 was primarily attributable to net business inflows, the reinvestment of net investment income, and the translation impact of the yen strengthening against the U.S. dollar, partially offset by an increase in U.S. interest rates.

As of December 31, 2018, our Japanese insurance operations had $64.9 billion, at carrying value, of investments denominated in U.S. dollars, including $2.5 billion that were hedged to yen through third-party derivative contracts and $50.0 billion that support liabilities denominated in U.S. dollars, with the remainder hedging our foreign currency exchange rate exposure on U.S. dollar-equivalent equity. As of December 31, 2017, our Japanese insurance operations had $62.6 billion, at carrying value, of investments denominated in U.S. dollars, including $5.8 billion that were hedged to yen through third-party derivative contracts and $43.8 billion that support liabilities denominated in U.S. dollars, with the remainder hedging our foreign currency exchange rate exposure on U.S. dollar-equivalent equity. The $2.3 billion increase in the carrying value of U.S. dollar-denominated investments from December 31, 2017 was primarily attributable to portfolio growth as a result of net business inflows and the reinvestment of net investment income, partially offset by the reduction of the U.S. dollar investments hedged back to yen through third-party derivatives.

Our Japanese insurance operations had $10.1 billion and $11.4 billion, at carrying value, of investments denominated in Australian dollars that support liabilities denominated in Australian dollars, as of December 31, 2018 and 2017,

respectively. The $1.3 billion decrease in the carrying value of Australian dollar-denominated investments from December 31, 2017, was primarily attributable to the translation impact of the Australian dollar weakening against the U.S. dollar and portfolio reduction as a result of net business outflows. For additional information regarding U.S. and Australian dollar investments held in our Japanese insurance operations and a discussion of our yen hedging strategy, see "—Results of Operations by Segment—Impact of Foreign Currency Exchange Rates" above.

Investment Results

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The following tables set forth the investment results of our general account apportioned between PFI excluding the Closed Block division and the Closed Block division, for the periods indicated. The yields are based on net investment income as reported under U.S. GAAP and as such do not include certain interest-related items, such as settlements of duration management swaps which are included in “Realized investment gains (losses), net.”

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| | Year Ended December 31, 2018 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | PFI Excluding Closed Block Division and Japanese Operations | | Japanese Insurance Operations | | PFI Excluding Closed Block Division | | Closed Block Division | Total(5) |
| | Yield(1) | Amount | Yield(1) | Amount | Yield(1) | Amount | Amount | Amount |
| | ($ in millions) | | | | | | | |
| Fixed maturities(2) | 4.68 % | $7,004 | 2.93 % | $3,707 | 3.87 % | $10,711 | $1,692 | $12,403 |
| Assets supporting experience-rated contractholder liabilities | 3.62 | 674 | 1.81 | 46 | 3.41 | 720 | 0 | 720 |
| Equity securities | 2.28 | 48 | 3.45 | 72 | 2.86 | 120 | 45 | 165 |
| Commercial mortgage and other loans | 4.03 | 1,299 | 3.96 | 623 | 4.01 | 1,922 | 407 | 2,329 |
| Policy loans | 5.44 | 258 | 3.92 | 101 | 4.91 | 359 | 263 | 622 |
| Short-term investments and cash equivalents | 2.20 | 265 | 2.83 | 33 | 2.25 | 298 | 30 | 328 |
| Gross investment income | 4.36 | 9,548 | 3.04 | 4,582 | 3.82 | 14,130 | 2,437 | 16,567 |
| Investment expenses | (0.15) | (397) | (0.13) | (237) | (0.14) | (634) | (204) | (838) |
| Investment income after investment expenses | 4.21 % | 9,151 | 2.91 % | 4,345 | 3.68 % | 13,496 | 2,233 | 15,729 |
| Other invested assets(3) | | 221 | | 93 | | 314 | 55 | 369 |
| Investment results of other entities and operations(4) | | 78 | | 0 | | 78 | 0 | 78 |
| Total investment income | | $9,450 | | $4,438 | | $13,888 | $2,288 | $16,176 |

| | Year Ended December 31, 2017 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | PFI Excluding Closed Block Division and Japanese Operations | | Japanese Insurance Operations | | PFI Excluding Closed Block Division | | Closed Block Division | Total(5) |
| | Yield(1) | Amount | Yield(1) | Amount | Yield(1) | Amount | Amount | Amount |
| | ($ in millions) | | | | | | | |
| Fixed maturities(2) | 4.61 % | $6,464 | 3.06 % | $3,624 | 3.90 % | $10,088 | $1,770 | $11,858 |
| Assets supporting experience-rated contractholder liabilities | 3.61 | 695 | 1.73 | 41 | 3.40 | 736 | 0 | 736 |
| Equity securities | 5.75 | 247 | 2.91 | 79 | 4.65 | 326 | 50 | 376 |
| Commercial mortgage and other loans | 4.13 | 1,285 | 4.05 | 515 | 4.10 | 1,800 | 449 | 2,249 |
| Policy loans | 5.41 | 250 | 4.00 | 97 | 4.92 | 347 | 271 | 618 |
| Short-term investments and cash equivalents | 1.31 | 158 | 1.25 | 14 | 1.31 | 172 | 25 | 197 |
| Gross investment income | 4.02 | 9,099 | 3.11 | 4,370 | 3.66 | 13,469 | 2,565 | 16,034 |
| Investment expenses | (0.14) | (306) | (0.12) | (184) | (0.13) | (490) | (177) | (667) |
| Investment income after investment expenses | 3.88 % | 8,793 | 2.99 % | 4,186 | 3.53 % | 12,979 | 2,388 | 15,367 |
| Other invested assets(3) | | 498 | | 132 | | 630 | 265 | 895 |
| Investment results of other entities and operations(4) | | 173 | | 0 | | 173 | 0 | 173 |
| Total investment income | | $9,464 | | $4,318 | | $13,782 | $2,653 | $16,435 |

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| | Year Ended December 31, 2016 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | PFI Excluding Closed Block Division and Japanese Operations | | Japanese Insurance Operations | | PFI Excluding Closed Block Division | | Closed Block Division | Total(5) |
| | Yield(1) | Amount | Yield(1) | Amount | Yield(1) | Amount | Amount | Amount |
| | ($ in millions) | | | | | | | |
| Fixed maturities(2) | 4.63 % | $6,043 | 3.14 % | $3,472 | 3.95 % | $9,515 | $1,696 | $11,211 |
| Assets supporting experience-rated contractholder liabilities | 3.80 | 721 | 1.75 | 37 | 3.59 | 758 | 0 | 758 |
| Equity securities | 5.40 | 232 | 2.46 | 75 | 4.18 | 307 | 59 | 366 |
| Commercial mortgage and other loans | 4.35 | 1,306 | 4.23 | 445 | 4.32 | 1,751 | 476 | 2,227 |
| Policy loans | 5.49 | 252 | 4.05 | 95 | 5.00 | 347 | 280 | 627 |
| Short-term investments and cash equivalents | 0.67 | 113 | 0.78 | 9 | 0.68 | 122 | 20 | 142 |
| Gross investment income | 4.26 | 8,667 | 3.19 | 4,133 | 3.84 | 12,800 | 2,531 | 15,331 |
| Investment expenses | (0.13) | (248) | (0.12) | (165) | (0.14) | (413) | (156) | (569) |
| Investment income after investment expenses | 4.13 % | 8,419 | 3.07 % | 3,968 | 3.70 % | 12,387 | 2,375 | 14,762 |
| Other invested assets(3) | | 344 | | 129 | | 473 | 203 | 676 |
| Investment results of other entities and operations(4) | | 82 | | 0 | | 82 | 0 | 82 |
| Total investment income | | $8,845 | | $4,097 | | $12,942 | $2,578 | $15,520 |

(1) The denominator in the yield percentage is based on quarterly average carrying values for all asset types except for fixed maturities which are based on amortized cost. Amounts for fixed maturities, short-term investments and cash equivalents are also netted for securities lending activity (i.e., income netted for rebate expenses and asset values netted for securities lending liabilities). A yield is not presented for other invested assets as it is not considered a meaningful measure of investment performance. Yields exclude investment income and assets related to other invested assets. Prior period yields have been revised to conform to current period presentation.
(2) Includes fixed maturity securities classified as available-for-sale and held-to-maturity and excludes fixed maturity securities classified as trading, which are included in other invested assets.
(3) Other invested assets consist of investments in LPs/LLCs, investment real estate held through direct ownership, derivative instruments, fixed maturities classified as trading and other miscellaneous investments.
(4) Includes net investment income of our investment management operations.
(5) The total yield was 3.77%, 3.68% and 3.82% for the years ended December 31, 2018, 2017 and 2016, respectively.

The increase in investment income after investment expenses yield attributable to our general account investments, excluding both the Closed Block division and the Japanese insurance operations' portfolio, for 2018 compared to 2017 was primarily the result of higher fixed income reinvestment rates.

The decrease in investment income after investment expenses yield attributable to our general account investments, excluding both the Closed Block division and the Japanese insurance operations' portfolio, for 2017 compared to 2016 was primarily the result of lower fixed income reinvestment rates.

The decrease in investment income after investment expenses yield on the Japanese insurance operations' portfolio for 2018 compared to 2017 was primarily attributable to lower fixed income reinvestment rates and lower fixed maturity prepayment fees and call premiums.

The decrease in investment income after investment expenses yield on the Japanese insurance operations' portfolio for 2017 compared to 2016 was primarily attributable to lower fixed income reinvestment rates, partially offset by higher fixed maturity prepayment fees and call premiums.

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 was approximately $44.3 billion and $41.4 billion, for the years ended December 31, 2018 and 2017, 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 was approximately $9.8 billion and $10.2 billion, for the years ended December 31, 2018 and 2017, respectively. The 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—Impact of Foreign Currency Exchange Rates” above.

Realized Investment Gains and Losses

The following table sets forth “Realized investment gains (losses), net” by investment type of our general account apportioned between PFI excluding Closed Block division and the Closed Block division as well as related charges and adjustments, for the periods indicated:

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | (in millions) | | |
| PFI excluding Closed Block Division: | | | |
| Realized investment gains (losses), net: | | | |
| Due to foreign exchange movements on securities approaching maturity | $(23) | $(36) | $(4) |
| Due to securities actively marketed for sale | (24) | (12) | (29) |
| Due to credit or adverse conditions of the respective issuer(1) | (169) | (121) | (111) |
| OTTI losses on fixed maturities recognized in earnings(2) | (216) | (169) | (144) |
| Net gains (losses) on sales and maturities | 504 | 577 | 761 |
| Fixed maturity securities(3) | 288 | 408 | 617 |
| OTTI losses on equity securities recognized in earnings(4) | 0 | (23) | (61) |
| Net gains (losses) on sales and maturities(6) | 0 | 588 | 188 |
| Equity securities(5) | 0 | 565 | 127 |
| Commercial mortgage and other loans | (15) | (2) | 2 |
| Derivative instruments | 1,249 | (1,061) | 1,011 |
| OTTI losses on other invested assets recognized in earnings(7) | (7) | (19) | (57) |
| Other net gains (losses) | 106 | 18 | 6 |
| Other | 99 | (1) | (51) |
| Subtotal | 1,621 | (91) | 1,706 |
| Investment results of other entities and operations(8) | 226 | (11) | 54 |
| Total — PFI excluding Closed Block Division | 1,847 | (102) | 1,760 |
| Related adjustments | (1,228) | (500) | (771) |
| Realized investment gains (losses), net, and related adjustments | 619 | (602) | 989 |
| Related charges | (316) | 544 | (466) |
| Realized investment gains (losses), net, and related charges and adjustments | $303 | $(58) | $523 |
| Closed Block Division: | | | |
| Realized investment gains (losses), net: | | | |
| Due to foreign exchange movements on securities approaching maturity | $(28) | $(15) | $(13) |
| Due to securities actively marketed for sale | (9) | (13) | 0 |
| Due to credit or adverse conditions of the respective issuer(1) | (26) | (70) | (65) |
| OTTI losses on fixed maturities recognized in earnings(2) | (63) | (98) | (78) |
| Net gains (losses) on sales and maturities(6) | 3 | 271 | 127 |
| Fixed maturity securities(3) | (60) | 173 | 49 |
| OTTI losses on equity securities recognized in earnings(4) | 0 | (4) | (13) |
| Net gains (losses) on sales and maturities | 0 | 505 | 262 |
| Equity securities(5) | 0 | 501 | 249 |
| Commercial mortgage and other loans | (6) | 0 | 1 |
| Derivative instruments | 193 | (128) | 162 |
| OTTI losses on other invested assets recognized in earnings(7) | (1) | (14) | (28) |
| Other net gains (losses) | 4 | 2 | 1 |
| Other | 3 | (12) | (27) |
| Subtotal — Closed Block Division | 130 | 534 | 434 |
| Consolidated PFI realized investment gains (losses), net | $1,977 | $432 | $2,194 |

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(1) 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.
(2) Excludes the portion of OTTI recorded in OCI, representing any difference between the fair value of the impaired debt security and the net present value of its projected future cash flows at the time of impairment.
(3) Includes fixed maturity securities classified as available-for-sale and held-to-maturity and excludes fixed maturity securities classified as trading.
(4) Effective January 1, 2018, the identification of OTTI for equity securities is no longer needed as all of these investments are now measured at fair value with changes in fair value reported in earnings.
(5) Effective January 1, 2018, realized gains (losses) on equity securities are recorded within "Other income (loss)."
(6) During 2016, fixed maturity prepayment fees and call premiums were reclassified to "Net investment income." Prior periods were not restated. The impact of this change was immaterial.
(7) Primarily includes OTTI related to investments in LPs/LLCs and real estate held through direct ownership.
(8) Includes "realized investment gains (losses), net" of our investment management operations.

2018 to 2017 Annual Comparison

Net gains on sales and maturities of fixed maturity securities were $504 million and $577 million for the years ended December 31, 2018 and 2017, respectively, primarily driven by the impact of foreign currency exchange rate movements of U.S. and Australian dollar-denominated securities that matured or were sold within our International Insurance segment.

Net realized gains on derivative instruments of $1,249 million, for the year ended December 31, 2018, primarily included:
- $575 million of gains on foreign currency hedges due to U.S. dollar and Japanese yen appreciation;
- $529 million of gains on product-related embedded derivatives and related hedge positions associated with certain variable annuity contracts;
- $363 million of gains on capital hedges due to decreases in equity indices;
- $150 million of gains for fees earned on fee-based synthetic GICs; and
- $362 million of losses on interest rate derivatives due to increases in swap and U.S. Treasury rates.

Net realized losses on derivative instruments of $1,061 million, for the year ended December 31, 2017, primarily included:
- $869 million of losses on product-related embedded derivatives and related hedge positions associated with certain variable annuity contracts;
- $462 million of losses on foreign currency hedges due to U.S. dollar depreciation;
- $350 million of losses on capital hedges due to increases in equity indices;
- $370 million of gains on interest rate derivatives due to decreases in long-term interest rates;
- $152 million of gains for fees earned on fee-based synthetic GICs; and
- $26 million of gains on foreign currency hedges due to Japanese yen appreciation.

For a discussion of living benefit guarantees and related hedge positions in our Individual Annuities segment, see "—Results of Operations by Segment—U.S. Individual Solutions Division—Individual Annuities" above.
Related adjustments include the portions of "Realized investment gains (losses), net" that are included in adjusted operating income and the portions of "Other income (loss)" and "Net investment income" that are excluded from adjusted operating income. These adjustments are made to arrive at "Realized investment gains (losses), net, and related

adjustments" which are excluded from adjusted operating income. Results for the years ended December 31, 2018 and 2017 reflected related adjustments of net negative $1,228 million and $500 million, respectively. Both periods' results were driven by settlements and changes in values of interest rate and currency derivatives. 2018 results also include the change in fair value of equity securities recorded within "Other income (loss)."
Charges that relate to "Realized investment gains (losses), net" are also excluded from adjusted operating income and may be reflected as net charges or net benefits. Results for the year ended December 31, 2018 reflected a net related charge of $316 million, compared to a net related benefit of $544 million for the year ended December 31, 2017. Both periods' results were driven by the impact of derivative activity on the amortization of DAC and other costs and certain policyholder reserves.
2017 to 2016 Annual Comparison

Net realized gains on sales and maturities of fixed maturity securities were $577 million and $761 million for the years ended December 31, 2017 and 2016, respectively, primarily driven by sales and maturities of U.S. dollar-denominated securities within International Insurance segment.

Net realized gains on derivative instruments of $1,011 million, for the year ended December 31, 2016, primarily included:

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- $523 million of gains on product-related embedded derivatives and related hedge positions associated with certain variable annuity contracts;
- $364 million of gains on foreign currency hedges due to U.S. dollar and Japanese yen appreciation; and
- $157 million of gains for fees earned on fee-based synthetic GICs.

For a discussion of living benefit guarantees and related hedge positions in our Individual Annuities segment, see "—Results of Operations by Segment—U.S. Individual Solutions Division—Individual Annuities" above.
Related adjustments for the years ended December 31, 2017 and 2016 included net negative related adjustments of $500 million and $771 million, respectively. Both periods' results were primarily driven by settlements and changes in values of interest rate and currency derivatives.
Related charges for the year ended December 31, 2017 included a net related benefit of $544 million, compared to net related charge of $466 million for the year ended December 31, 2016. Both periods' results were driven by the impact of derivative activity on the amortization of DAC and other costs and certain policyholder reserves.
Impairments

The level of OTTI generally reflects economic conditions and is expected to increase when economic conditions worsen and to decrease when economic conditions improve. Historically, the causes of OTTI have been specific to each individual issuer and have not directly resulted in impairments to other securities within the same industry or geographic region. We may also realize additional credit and interest rate-related losses through sales of investments pursuant to our credit risk and portfolio management objectives.

We maintain separate monitoring processes for public and private fixed maturities and create watch lists to highlight securities that require special scrutiny and management. 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 public and private fixed maturity investment managers formally review all public and 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.

For LPs/LLCs accounted for using the equity method, the carrying value of these investments is written down or impaired
to fair value when a decline in value is considered to be other-than-temporary. For additional information regarding our OTTI
policies, see Note 2 to the Consolidated Financial Statements.

Retail-Related Investments

As of December 31, 2018, PFI excluding the Closed Block division had retail-related investments of approximately $14 billion consisting primarily of $6 billion of corporate fixed maturities of which 88% were considered investment grade; $7 billion of commercial mortgage loans with a weighted-average loan-to-value ratio of approximately 51% and weighted-average debt service coverage ratio of 2.45 times; and $1 billion of real estate held through direct ownership and real estate-related LPs/LLCs.

In addition, we held approximately $9 billion of commercial mortgage-backed securities, of which approximately 84% and 16% were rated AAA (super-senior) and AA, respectively, and comprised of diversified collateral pools. Approximately 30% of the collateral pools were comprised of retail-related investments, with no pools solely

collateralized by retail-related investments. For additional information regarding commercial mortgage-backed securities, see “—Fixed Maturity Securities—Fixed Maturity Securities Credit Quality” below.

General Account Investments of PFI excluding Closed Block Division

In the following sections, we provide details about our investment portfolio, excluding investments held in the Closed Block division. We believe the details of the composition of our investment portfolio excluding the Closed Block division are most relevant to an understanding of our operations that are pertinent to investors in Prudential Financial, Inc. because substantially all Closed Block division assets support obligations and liabilities relating to the Closed Block policies only. See Note 14 to the Consolidated Financial Statements for further information on the Closed Block.

Fixed Maturity Securities

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In the following sections, we provide details about our fixed maturity securities portfolio, which excludes fixed maturity securities classified as assets supporting experienced-rated contractholder liabilities and classified as trading.

Fixed Maturity Securities by Contractual Maturity Date

The following table sets forth the breakdown of the amortized cost of our fixed maturity securities portfolio by contractual maturity, as of the date indicated:

| | December 31, 2018 | | |
|---|---|---|---|
| | Amortized Cost | % of Total | |
| | ($ in millions) | | |
| Corporate & government securities: | | | |
| Maturing in 2019 | $7,540 | 2.6 | % |
| Maturing in 2020 | 12,378 | 4.2 | |
| Maturing in 2021 | 11,672 | 4.0 | |
| Maturing in 2022 | 10,316 | 3.5 | |
| Maturing in 2023 | 12,705 | 4.3 | |
| Maturing in 2024 | 11,805 | 4.0 | |
| Maturing in 2025 | 11,871 | 4.0 | |
| Maturing in 2026 | 12,125 | 4.1 | |
| Maturing in 2027 | 13,044 | 4.4 | |
| Maturing in 2028 | 10,576 | 3.6 | |
| Maturing in 2029 | 7,423 | 2.5 | |
| Maturing in 2030 and beyond | 151,693 | 51.4 | |
| Total corporate & government securities | 273,148 | 92.6 | |
| Asset-backed securities | 9,803 | 3.3 | |
| Commercial mortgage-backed securities | 8,953 | 3.0 | |
| Residential mortgage-backed securities | 3,205 | 1.1 | |
| Total fixed maturities | $295,109 | 100.0 | % |

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 PFI excluding the Closed Block division and the associated gross unrealized gains and losses, as of the dates indicated:

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| Industry(1) | December 31, 2018 Amortized Cost | Gross Unrealized Gains(2) | Gross Unrealized Losses(2) | Fair Value | December 31, 2017 Amortized Cost | Gross Unrealized Gains(2) | Gross Unrealized Losses(2) | Fair Value |
|---|---|---|---|---|---|---|---|---|
| | (in millions) | | | | | | | |
| Corporate securities: | | | | | | | | |
| Finance | $29,831 | $ 726 | $ 724 | $29,833 | $25,906 | $ 1,646 | $ 84 | $27,468 |
| Consumer non-cyclical | 24,136 | 1,172 | 748 | 24,560 | 24,812 | 2,359 | 140 | 27,031 |
| Utility | 22,179 | 1,073 | 624 | 22,628 | 22,265 | 2,196 | 118 | 24,343 |
| Capital goods | 11,623 | 561 | 386 | 11,798 | 11,232 | 1,076 | 52 | 12,256 |
| Consumer cyclical | 11,001 | 429 | 330 | 11,100 | 11,011 | 972 | 77 | 11,906 |
| Foreign agencies | 5,946 | 785 | 91 | 6,640 | 5,619 | 996 | 17 | 6,598 |
| Energy | 11,753 | 524 | 553 | 11,724 | 10,621 | 998 | 137 | 11,482 |
| Communications | 6,163 | 455 | 234 | 6,384 | 6,266 | 782 | 77 | 6,971 |
| Basic industry | 5,431 | 238 | 158 | 5,511 | 6,061 | 590 | 37 | 6,614 |
| Transportation | 8,633 | 428 | 225 | 8,836 | 8,179 | 777 | 28 | 8,928 |
| Technology | 3,855 | 155 | 99 | 3,911 | 4,373 | 318 | 33 | 4,658 |
| Industrial other | 3,764 | 151 | 154 | 3,761 | 3,866 | 348 | 23 | 4,191 |
| Total corporate securities | 144,315 | 6,697 | 4,326 | 146,686 | 140,211 | 13,058 | 823 | 152,446 |
| Foreign government(3) | 97,087 | 16,942 | 301 | 113,728 | 88,539 | 15,848 | 291 | 104,096 |
| Residential mortgage-backed(4) | 3,205 | 120 | 31 | 3,294 | 3,801 | 191 | 10 | 3,982 |
| Asset-backed | 9,803 | 122 | 62 | 9,863 | 8,389 | 214 | 7 | 8,596 |
| Commercial mortgage-backed | 8,953 | 87 | 86 | 8,954 | 8,850 | 188 | 64 | 8,974 |
| U.S. Government | 22,290 | 2,563 | 569 | 24,284 | 16,591 | 3,005 | 306 | 19,290 |
| State & Municipal | 9,456 | 607 | 63 | 10,000 | 8,945 | 1,016 | 6 | 9,955 |
| Total(5) | $295,109 | $ 27,138 | $ 5,438 | $316,809 | $275,326 | $ 33,520 | $ 1,507 | $307,339 |

(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 $359 million of gross unrealized gains and less than $1 million of gross unrealized losses, as of December 31, 2018, compared to $381 million of gross unrealized gains and less than $1 million of gross unrealized losses, as of December 31, 2017, on securities classified as held-to-maturity.

(3) As of December 31, 2018 and 2017, based on amortized cost, 76% and 75%, respectively, represent Japanese government bonds held by our Japanese insurance operations with no other individual country representing more than 11% of the balance.

(4) As of both December 31, 2018 and 2017, based on amortized cost, more than 99% were rated A or higher.

(5) 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.

The decrease in net unrealized gains from December 31, 2017 to December 31, 2018 was primarily due to an increase in U.S. interest rates and credit spread widening.

Fixed Maturity Securities Credit Quality

The Securities Valuation Office ("SVO") of the National Association of Insurance Commissioners ("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 Investor Service, Inc. ("Moody's") or BBB- or higher by Standard & Poor's Rating Services ("S&P"). 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 S&P. The NAIC Designations for commercial mortgage-backed securities and non-agency residential 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.

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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 includes certain securities that have not yet been designated by the SVO as of each balance sheet date. Pending receipt of SVO designations, 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 ("FSA"), an agency of the Japanese government. The FSA has its own investment quality criteria and risk control standards. Our Japanese insurance companies comply with the FSA'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 and S&P, or rating equivalents based on ratings assigned by Japanese credit ratings agencies.

The following table sets forth our fixed maturity portfolio by NAIC Designation or equivalent ratings attributable to PFI excluding the Closed Block division, as of the dates indicated:

| NAIC Designation(1)(2) | December 31, 2018 | | | | December 31, 2017 | | | |
|---|---|---|---|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains(3) | Gross Unrealized Losses(3)(4) | Fair Value | Amortized Cost | Gross Unrealized Gains(3) | Gross Unrealized Losses(3)(4) | Fair Value |
| | (in millions) | | | | | | | |
| 1 | $222,290 | $ 24,138 | $ 2,568 | $243,860 | $207,791 | $ 27,550 | $ 925 | $234,416 |
| 2 | 55,768 | 2,267 | 1,999 | 56,036 | 50,751 | 4,560 | 335 | 54,976 |
| Subtotal High or Highest Quality Securities(5) | 278,058 | 26,405 | 4,567 | 299,896 | 258,542 | 32,110 | 1,260 | 289,392 |
| 3 | 10,149 | 330 | 408 | 10,071 | 10,201 | 670 | 79 | 10,792 |
| 4 | 5,254 | 291 | 368 | 5,177 | 4,681 | 501 | 105 | 5,077 |
| 5 | 1,395 | 99 | 77 | 1,417 | 1,666 | 225 | 57 | 1,834 |
| 6 | 253 | 13 | 18 | 248 | 236 | 14 | 6 | 244 |
| Subtotal Other Securities(6)(7) | 17,051 | 733 | 871 | 16,913 | 16,784 | 1,410 | 247 | 17,947 |
| Total fixed maturities | $295,109 | $ 27,138 | $ 5,438 | $316,809 | $275,326 | $ 33,520 | $ 1,507 | $307,339 |

(1) Reflects equivalent ratings for investments of the international insurance operations.

(2) Includes, as of December 31, 2018 and 2017, 1,744 securities with amortized cost of $9,079 million (fair value, $9,135 million) and 982 securities with amortized cost of $6,022 million (fair value, $6,217 million), respectively, that have been categorized based on expected NAIC Designations pending receipt of SVO ratings.

(3) Includes $359 million of gross unrealized gains and less than $1 million of gross unrealized losses, as of December 31, 2018, compared to $381 million of gross unrealized gains and less than $1 million of gross unrealized losses, as of December 31, 2017, on securities classified as held-to-maturity.

(4) As of December 31, 2018, includes gross unrealized losses of $591 million on public fixed maturities and $280 million on private fixed maturities considered to be other than high or highest quality and, as of December 31, 2017, includes gross unrealized losses of $156 million on public fixed maturities and $91 million on private fixed maturities considered to be other than high or highest quality.

(5) On an amortized cost basis, as of December 31, 2018, includes $238,824 million of public fixed maturities and $39,234 million of private fixed maturities and, as of December 31, 2017, includes $222,763 million of public fixed maturities and $35,779 million of private fixed maturities.

(6) On an amortized cost basis, as of December 31, 2018, includes $10,588 million of public fixed maturities and $6,463 million of private fixed maturities and, as of December 31, 2017, includes $9,975 million of public fixed

maturities and $6,809 million of private fixed maturities.

(7) On an amortized cost basis, as of December 31, 2018, securities considered below investment grade based on lowest of external rating agency ratings, total $19,154 million, or approximately 6% of the total fixed maturities, and include securities considered high or highest quality by the NAIC based on the rules described above.

Asset-Backed and Commercial Mortgage-Backed Securities

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The following table sets forth information pertaining to asset-backed and commercial mortgage-backed securities within our fixed maturity available-for-sale portfolio attributable to PFI excluding the Closed Block division:

| Lowest Rating Agency Rating(1) | December 31, 2018 | | | | December 31, 2017 | | | |
|---|---|---|---|---|---|---|---|---|
| | Asset-Backed Securities(2) | | Commercial Mortgage-Backed Securities(3) | | Asset-Backed Securities(2) | | Commercial Mortgage-Backed Securities(3) | |
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| | (in millions) | | | | | | | |
| AAA | $9,188 | $9,151 | $ 7,523 | $ 7,528 | $7,613 | $7,686 | $ 8,002 | $ 8,125 |
| AA | 405 | 430 | 1,415 | 1,410 | 419 | 442 | 816 | 818 |
| A | 30 | 36 | 6 | 7 | 40 | 46 | 23 | 22 |
| BBB | 15 | 15 | 9 | 9 | 42 | 43 | 9 | 9 |
| BB and below | 165 | 231 | 0 | 0 | 275 | 379 | 0 | 0 |
| Total(4) | $9,803 | $9,863 | $ 8,953 | $ 8,954 | $8,389 | $8,596 | $ 8,850 | $ 8,974 |

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(1) The table above provides ratings as assigned by nationally recognized rating agencies as of December 31, 2018, including S&P, Moody's, Fitch Ratings Inc. ("Fitch") and Morningstar.

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

(3) As of December 31, 2018 and 2017, based on amortized cost, 96% and 95%, respectively, were securities with vintages of 2013 or later.

(4) Excludes fixed maturity securities classified as "Assets supporting experience-rated contractholder liabilities" and "Fixed maturities, trading", as well as securities held outside the general account in other entities and operations.

Included in "Asset-backed securities" above are investments in collateralized loan obligations ("CLOs"). The following table sets forth information pertaining to these investments in CLOs within our fixed maturity available-for-sale portfolio attributable to PFI excluding the Closed Block division:

| Lowest Rating Agency Rating(1) | December 31, 2018 | | December 31, 2017 | |
|---|---|---|---|---|
| | Collateralized Loan Obligations | | | |
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| | (in millions) | | | |
| AAA | $7,355 | $7,318 | $6,609 | $6,679 |
| AA | 0 | 0 | 0 | 0 |
| A | 0 | 0 | 0 | 0 |
| BBB | 0 | 0 | 0 | 0 |
| BB and below | 0 | 0 | 0 | 0 |
| Total(2) | $7,355 | $7,318 | $6,609 | $6,679 |

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(1) The table above provides ratings as assigned by nationally recognized rating agencies as of December 31, 2018, including S&P, Moody's, Fitch and Morningstar.

(2) Excludes fixed maturity securities classified as "Assets supporting experience-rated contractholder liabilities" and "Fixed maturities, trading", as well as securities held outside the general account in other entities and operations.

Assets Supporting Experience-Rated Contractholder Liabilities

For information regarding the composition of "Assets supporting experience-rated contractholder liabilities," see Note 3 to the Consolidated Financial Statements.

Commercial Mortgage and Other Loans

Investment Mix

The following table sets forth the composition of our commercial mortgage and other loans portfolio attributable to PFI excluding the Closed Block division, as of the dates indicated:

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| | December 31, 2018 | December 31, 2017 |
|---|---|---|
| | (in millions) | |
| Commercial mortgage and agricultural property loans | $49,524 | $45,623 |
| Uncollateralized loans | 658 | 661 |
| Residential property loans | 158 | 196 |
| Other collateralized loans | 17 | 5 |
| Total recorded investment gross of allowance(1) | 50,357 | 46,485 |
| Allowance for credit losses | (106) | (91) |
| Total net commercial mortgage and other loans(2) | $50,251 | $46,394 |

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(1) As a percentage of recorded investment gross of allowance, more than 99% of these assets were current as of both December 31, 2018 and 2017.

(2) Excluded from the table above are commercial mortgage and other loans held outside the general account in other entities and operations. For additional information regarding commercial mortgage and other loans held outside the general account, see "—Invested Assets of Other Entities and Operations" below.

We originate commercial mortgage and agricultural property loans using a dedicated investment staff through our various regional offices in the U.S. and international offices primarily in London and Tokyo. 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 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 include consumer loans.

Composition of Commercial Mortgage and Agricultural Property Loans

Our commercial mortgage and agricultural property loan portfolio strategy emphasizes diversification by property type and geographic location. The following tables set forth the breakdown of the gross carrying values of commercial mortgage and agricultural property loans attributable to PFI excluding the Closed Block division by geographic region and property type, as of the dates indicated:

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| | December 31, 2018 | | December 31, 2017 | |
|---|---|---|---|---|
| | Gross Carrying Value | % of Total | Gross Carrying Value | % of Total |
| | ($ in millions) | | | |
| Commercial mortgage and agricultural property loans by region: | | | | |
| U.S. Regions(1): | | | | |
| Pacific | $16,553 | 33.4 % | $14,965 | 32.8 % |
| South Atlantic | 8,633 | 17.4 | 8,666 | 19.0 |
| Middle Atlantic | 6,088 | 12.3 | 5,776 | 12.7 |
| East North Central | 2,813 | 5.7 | 2,440 | 5.3 |
| West South Central | 5,044 | 10.2 | 4,671 | 10.2 |
| Mountain | 2,508 | 5.0 | 2,027 | 4.5 |
| New England | 1,879 | 3.8 | 1,774 | 3.9 |
| West North Central | 476 | 1.0 | 641 | 1.4 |
| East South Central | 595 | 1.2 | 612 | 1.3 |
| Subtotal-U.S. | 44,589 | 90.0 | 41,572 | 91.1 |
| Europe | 3,077 | 6.2 | 2,528 | 5.5 |
| Asia | 733 | 1.5 | 619 | 1.4 |
| Other | 1,125 | 2.3 | 904 | 2.0 |
| Total commercial mortgage and agricultural property loans | $49,524 | 100.0% | $45,623 | 100.0% |

(1) Regions as defined by the United States Census Bureau.

| | December 31, 2018 | | December 31, 2017 | |
|---|---|---|---|---|
| | Gross Carrying Value | % of Total | Gross Carrying Value | % of Total |
| | ($ in millions) | | | |
| Commercial mortgage and agricultural property loans by property type: | | | | |
| Industrial | $10,490 | 21.2 % | $8,444 | 18.5 % |
| Retail | 6,693 | 13.5 | 6,595 | 14.5 |
| Office | 10,971 | 22.1 | 10,020 | 22.0 |
| Apartments/Multi-Family | 13,818 | 27.9 | 12,993 | 28.5 |
| Other | 3,255 | 6.6 | 3,336 | 7.3 |
| Agricultural properties | 2,710 | 5.5 | 2,526 | 5.5 |
| Hospitality | 1,587 | 3.2 | 1,709 | 3.7 |
| Total commercial mortgage and agricultural property loans | $49,524 | 100.0% | $45,623 | 100.0% |

Loan-to-value and debt service coverage ratios are measures commonly used to assess the quality of commercial mortgage and agricultural property 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. A loan-to-value ratio less than 100% indicates an excess of collateral value over the loan amount. Loan-to-value ratios greater than 100% indicate that the loan amount exceeds the collateral value. 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 debt service coverage ratio greater than 1.0 times indicates an excess of net operating income over the debt service payments.

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As of December 31, 2018, our commercial mortgage and agricultural property loans attributable to PFI excluding the Closed Block division had a weighted-average debt service coverage ratio of 2.42 times and a weighted-average loan-to-value ratio of 56%. As of December 31, 2018, 97% of commercial mortgage and agricultural property loans were fixed rate loans. For those commercial mortgage and agricultural property loans that were originated in 2018, the weighted-average debt service coverage ratio was 2.39 times, and the weighted-average loan-to-value ratio was 64%.

The values utilized in calculating these loan-to-value ratios are developed as part of our periodic review of the commercial mortgage and agricultural property 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 credit 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 mortgage and agricultural property loan portfolio included $0.7 billion and approximately $1.0 billion of such loans as of December 31, 2018 and 2017, respectively. All else being equal, these loans are inherently riskier than those collateralized by properties that have already stabilized. As of December 31, 2018, there were no loan-specific reserves related to these loans. In addition, these unstabilized loans are included in the calculation of our portfolio reserve as discussed below.

The following table sets forth the gross carrying value of our commercial mortgage and agricultural property loans attributable to PFI excluding the Closed Block division by loan-to-value and debt service coverage ratios, as of the date indicated:

| | December 31, 2018 | | | |
|---|---|---|---|---|
| | Debt Service Coverage Ratio | | | |
| | > 1.2x | 1.0x to < 1.2x | < 1.0x | Total Commercial Mortgage and Agricultural Property Loans |
| Loan-to-Value Ratio | (in millions) | | | |
| 0%-59.99% | $26,977 | $607 | $195 | $ 27,779 |
| 60%-69.99% | 14,260 | 543 | 0 | 14,803 |
| 70%-79.99% | 5,850 | 621 | 31 | 6,502 |
| 80% or greater | 317 | 113 | 10 | 440 |
| Total commercial mortgage and agricultural property loans | $47,404 | $1,884 | $236 | $ 49,524 |

The following table sets forth the breakdown of our commercial mortgage and agricultural property loans attributable to PFI excluding the Closed Block division by year of origination, as of the date indicated:

| | December 31, 2018 | |
|---|---|---|
| | Gross Carrying Value | % of Total |
| Year of Origination | ($ in millions) | |
| 2018 | $8,989 | 18.2 % |

| | | |
|---|---|---|
| 2017 | 7,958 | 16.1 |
| 2016 | 7,028 | 14.2 |
| 2015 | 6,750 | 13.6 |
| 2014 | 5,998 | 12.1 |
| 2013 | 5,558 | 11.2 |
| 2012 | 3,009 | 6.1 |
| 2011 & Prior | 4,234 | 8.5 |
| Total commercial mortgage and agricultural property loans | $49,524 | 100.0% |

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Commercial Mortgage and Other Loans by Contractual Maturity Date

The following table sets forth the breakdown of our commercial mortgage and other loans portfolio by contractual maturity, as of the date indicated:

| Vintage | December 31, 2018 Gross Carrying Value | % of Total |
|---|---|---|
| | ($ in millions) | |
| Maturing in 2019 | $1,415 | 2.8 % |
| Maturing in 2020 | 3,414 | 6.8 |
| Maturing in 2021 | 3,584 | 7.1 |
| Maturing in 2022 | 3,623 | 7.2 |
| Maturing in 2023 | 3,836 | 7.6 |
| Maturing in 2024 | 4,909 | 9.7 |
| Maturing in 2025 | 6,375 | 12.7 |
| Maturing in 2026 | 4,323 | 8.6 |
| Maturing in 2027 | 4,394 | 8.7 |
| Maturing in 2028 | 5,016 | 10.0 |
| Maturing in 2029 | 1,905 | 3.8 |
| Maturing in 2030 and beyond | 7,563 | 15.0 |
| Total commercial mortgage and other loans | $50,357 | 100.0 % |

Commercial Mortgage and Other Loans Quality

The commercial mortgage and other loans portfolio is reviewed on an ongoing basis. If certain criteria are met, loans are assigned to either of the following "watch list" categories:

(1) "Closely Monitored," which includes a variety of considerations, such as when loan metrics fall below acceptable levels, the borrower is not cooperative or has requested a material modification, or the portfolio manager has directed a change in category; or
(2) "Not in Good Standing," which includes loans in default or with a high probability of loss of principal, such as when the loan is in the process of foreclosure or the borrower is in bankruptcy.
Our workout and special servicing professionals manage the loans on the watch list.

We establish an allowance for credit 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 allowance for credit losses is based on our assessment as to ultimate collectability of loan principal and interest. Allowances for credit losses 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 allowance for credit losses for commercial mortgage and other loans can increase or decrease from period to period based on these factors.

The following table sets forth the change in allowance for credit losses for our commercial mortgage and other loans portfolio, as of the dates indicated:

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| | December 31, 2018 | December 31, 2017 |
|---|---|---|
| | (in millions) | |
| Allowance, beginning of year | $91 | $ 90 |
| Addition to (release of) allowance for credit losses | 15 | 1 |
| Charge-offs, net of recoveries | 0 | 0 |
| Change in foreign exchange | 0 | 0 |
| Allowance, end of period | $106 | $ 91 |
| Loan-specific reserve | $11 | $ 5 |
| Portfolio reserve | $95 | $ 86 |

The allowance for credit losses as of December 31, 2018 increased compared to December 31, 2017 primarily due to additions to the loan-specific reserve from credit quality deterioration of certain loans in the portfolio.

Equity Securities

The equity securities attributable to PFI excluding the Closed Block division 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 and the associated gross unrealized gains and losses, as of the dates indicated:

| | December 31, 2018 | | | | December 31, 2017 | | | |
|---|---|---|---|---|---|---|---|---|
| | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| | (in millions) | | | | | | | |
| Mutual funds | $769 | $ 87 | $ 13 | $843 | $778 | $ 157 | $ 0 | $935 |
| Other common stocks | 2,353 | 751 | 118 | 2,986 | 2,215 | 1,145 | 30 | 3,330 |
| Non-redeemable preferred stocks | 24 | 0 | 4 | 20 | 11 | 1 | 1 | 11 |
| Equity securities, at fair value(1)(2) | $3,146 | $ 838 | $ 135 | $3,849 | $3,004 | $ 1,303 | $ 31 | $4,276 |

(1) Amounts presented exclude investments in private equity and hedge funds and other investments which are reported in “Other invested assets.”

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

The net change in unrealized gains (losses) from equity securities attributable to PFI excluding Closed Block division still held at period end, recorded within “Other income (loss),” was $(569) million as of December 31, 2018.

Other Invested Assets

The following table sets forth the composition of “Other invested assets” attributable to PFI excluding the Closed Block division, as of the dates indicated:

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| | December 31, 2018 | December 31, 2017 |
|---|---|---|
| | (in millions) | |
| LPs/LLCs: | | |
| Equity method: | | |
| Private equity | $2,318 | $ 2,067 |
| Hedge funds | 836 | 400 |
| Real estate-related | 544 | 268 |
| Subtotal equity method | 3,698 | 2,735 |
| Fair value: | | |
| Private equity | 938 | 731 |
| Hedge funds | 1,256 | 1,361 |
| Real estate-related | 44 | 63 |
| Subtotal fair value(1) | 2,238 | 2,155 |
| Total LPs/LLCs | 5,936 | 4,890 |
| Real estate held through direct ownership(2) | 1,777 | 1,875 |
| Derivative instruments | 42 | 113 |
| Other(3) | 652 | 632 |
| Total other invested assets(4) | $8,407 | $ 7,510 |

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(1) As of December 31, 2017, $794 million was accounted for using the cost method.

(2) As of December 31, 2018 and 2017, real estate held through direct ownership had mortgage debt of $776 million and $799 million, respectively.

(3) Primarily includes leveraged leases, 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 16 to the Consolidated Financial Statements.

(4) Prior period amounts have been reclassified to conform to current period presentation. For additional information, see Note 2 to the Consolidated Financial Statements.

Invested Assets of Other Entities and Operations

"Invested Assets of Other Entities and Operations" presented below includes investments held outside the general account and primarily represents investments associated with our investment management operations and derivative operations. Our derivative operations act on behalf of affiliates primarily to manage interest rate, foreign currency, credit and equity exposures. Assets within our investment management operations that are managed for third parties and those assets classified as "Separate account assets" on our balance sheet are not included.

| | December 31, 2018 | December 31, 2017 |
|---|---|---|
| | (in millions) | |
| Fixed maturities: | | |
| Public, available-for-sale, at fair value(1) | $473 | $ 608 |
| Private, available-for-sale, at fair value | 1 | 1 |
| Fixed maturities, trading, at fair value(1) | 1,155 | 1,718 |
| Equity securities, at fair value | 605 | 574 |
| Commercial mortgage and other loans, at book value(2) | 797 | 634 |
| Other invested assets(1) | 2,803 | 2,704 |

| | | |
|---|---|---|
| Short-term investments | 43 | 66 |
| Total investments(3) | $5,877 | $ 6,305 |

(1) As of December 31, 2018 and 2017, balances include investments in collateralized loan obligations with fair value of $408 million and $563 million respectively.

(2) Book value is generally based on unpaid principal balance, net of any allowance for credit losses, or at fair value, when the fair value option has been elected.

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

Fixed Maturities, Trading

“Fixed maturities, trading, at fair value” are primarily related to assets associated with consolidated variable interest entities for which the Company is the investment manager. The assets of the consolidated variable interest entities are generally offset by liabilities for which the fair value option has been elected. For further information on these consolidated variable interest entities, see Note 4 to the Consolidated Financial Statements.

Commercial Mortgage and Other Loans

Our investment management operations include our commercial mortgage operations, which provide mortgage origination, investment management and servicing for our general account, institutional clients, the Federal Housing Administration and government-sponsored entities such as Fannie Mae and Freddie Mac.

The mortgage loans of our commercial mortgage operations are included in “Commercial mortgage and other loans.” Derivatives and other hedging instruments related to our commercial mortgage operations are primarily included in “Other invested assets.”

Other Invested Assets

“Other invested assets” primarily include assets of our derivative operations used to manage interest rate, foreign currency, credit and equity exposures.

Furthermore, other invested assets include strategic investments made as part of our investment 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 investment management operations, we also make loans to our managed funds that are secured by equity commitments from investors or assets of the funds. “Other invested assets” also includes certain assets in consolidated investment funds where the Company is deemed to exercise control over 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 operations 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.

Effective and prudent liquidity and capital management is a priority across the organization. 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 periodic planning process. We believe that cash flows from the sources of funds available to us are sufficient to satisfy the current liquidity requirements of Prudential Financial and its subsidiaries, including under reasonably foreseeable stress scenarios. We have a capital management framework in place that governs the allocation of capital and approval of capital uses. We also employ a Capital Protection Framework to

ensure the availability of capital resources to maintain adequate capitalization on a consolidated basis for our insurance subsidiaries under various stress scenarios.

Our businesses are subject to comprehensive regulation and supervision by domestic and international regulators. These regulations currently include, or may include in the future requirements and limitations (many of which are the subject of ongoing rule-making) relating to capital, leverage, liquidity, stress-testing, overall risk management, credit exposure reporting and credit concentration. For information on these regulatory initiatives and their potential impact on us, see “Business—Regulation.”

During 2018, we took the following significant actions that impacted our liquidity and capital position:

- We repurchased $1.5 billion of shares of our Common Stock and declared aggregate Common Stock dividends of $1.5 billion;
- We issued $1.6 billion of junior subordinated notes and $1.0 billion of medium-term notes to be utilized for general corporate purposes, which included refinancing portions of our medium-term notes maturing during 2018;

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- We redeemed our $600 million 8.875% Fixed-to-Floating Rate Junior Subordinated Note due 2068;
- We obtained additional financing for Regulation XXX reserves by entering into a new captive financing facility for $1.6 billion, of which $550 million was outstanding as of December 31, 2018;
- We obtained additional financing for Guideline AXXX reserves by increasing an existing captive financing facility by $1 billion, for a total of $2 billion, of which $1,466 million was outstanding as of December 31, 2018; and
- We entered into a yearly renewable term reinsurance agreement which resulted in a reduction in risk-based capital required to be held in our Group Insurance segment.

Capital

Our capital management framework is primarily based on statutory Risk-Based Capital (“RBC”) and solvency margin 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.

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 S&P, Moody’s, and Fitch, and “a” for A.M. Best Company (“A.M. Best”). Our financial strength rating targets for our life insurance companies are “AA/Aa/AA” for S&P, Moody’s and Fitch, respectively, and “A+” for A.M. Best. Some entities may currently be rated below these targets, and not all life insurance companies are rated by each of these rating agencies. See “—Ratings” below for a description of the potential impacts of ratings downgrades.

Capital Governance

Our capital management framework is ultimately reviewed and approved by our Board. The Board has adopted a Capital Policy that authorizes our Chairman and Chief Executive Officer and Vice Chairman to approve certain capital actions on behalf of the Company and to further delegate authority with respect to capital actions to appropriate officers. Any capital commitment that exceeds the authority granted to senior management under the capital policy is separately authorized by the Board.

In addition, our Capital and Finance Committee (“CFC”) reviews the use and allocation of capital above certain threshold amounts to promote the efficient use of capital, consistent with our strategic objectives, ratings aspirations and other goals and targets. This management committee provides a multi-disciplinary due diligence review of specific initiatives or transactions requiring the use of capital, including mergers and acquisitions. The CFC also reviews our annual capital plan (and updates to this plan), as well as our capital, liquidity and financial position, borrowing plans, and related matters prior to the discussion of these items with the Board.

Capitalization

The primary components of the Company’s capitalization consist of equity and outstanding capital debt, including junior subordinated debt. As shown in the table below, as of December 31, 2018, the Company had $51.1 billion in capital, all of which was available to support the aggregate capital requirements of its divisions and its Corporate and Other operations. Based on our assessment of these businesses and operations, we believe this level of capital is consistent with our ratings targets.

| | December 31, | |
|---|---|---|
| | 2018 | 2017 |
| | (in millions) | |

| | | |
|---|---|---|
| Equity(1)(2) | $37,711 | $37,162 |
| Junior subordinated debt (including hybrid securities) | 7,568 | 6,622 |
| Other capital debt | 5,793 | 5,402 |
| Total capital | $51,072 | $49,186 |

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(1) Amounts attributable to Prudential Financial, excluding AOCI.
(2) Prior period amount has been restated to conform to current period presentation. See Note 1 and Note 2 to our Consolidated Financial Statements for details.

Insurance Regulatory Capital

We manage Prudential Insurance, The Prudential Life Insurance Company, Ltd. (“Prudential of Japan”), Gibraltar Life, and other significant insurance subsidiaries to regulatory capital levels consistent with our “AA” ratings targets. We utilize the RBC ratio as a primary measure of the capital adequacy of our domestic insurance subsidiaries and the solvency margin ratio as a primary measure of the capital adequacy of our Japanese insurance subsidiaries.

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RBC is calculated based on statutory financial statements and risk formulas consistent with the practices of the NAIC. RBC considers, 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. RBC ratio calculations are intended to assist insurance regulators in measuring an insurer's solvency and ability to pay future claims. 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, but is available to the public.

The table below presents the RBC ratios of our most significant domestic insurance subsidiaries as of December 31, 2017, the most recent statutory fiscal year-end for these subsidiaries for which RBC information has been filed.

| | Ratio (1) | |
|---|---|---|
| Prudential Insurance(2) | 410 | % |
| PALAC | 1,034 | % |
| Composite Major U.S. Insurance Subsidiaries(3) | 529 | % |

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(1) The RBC ratio calculations are intended to assist insurance regulators in measuring an insurer's solvency and ability to pay future claims. 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, but is available to the public.

(2) Includes Prudential Retirement Insurance and Annuity Company ("PRIAC"), Pruco Life Insurance Company ("Pruco Life"), Pruco Life Insurance Company of New Jersey ("PLNJ"), which is a subsidiary of Pruco Life, and Prudential Legacy Insurance Company of New Jersey ("PLIC").

(3) Includes Prudential Insurance and its subsidiaries, as noted above, and Prudential Annuities Life Assurance Corporation ("PALAC"). Composite RBC is not reported to regulators and is based on the summation of total adjusted capital and risk charges for the included companies as determined under statutory accounting and RBC guidance to calculate a composite numerator and denominator, respectively, for purposes of calculating the composite ratio.

In June 2018, the Capital Adequacy Task Force of the NAIC approved revisions to the NAIC RBC framework as a result of the adoption of the Tax Act of 2017 and the corresponding reduction of the corporate tax rate from 35% to 21%. The revisions apply to the calculation of our domestic insurance life insurance companies' RBC ratios as of December 31, 2018. While there is no impact on our ability to pay claims, the revisions to the RBC framework for the reduction of the corporate tax rate under the Tax Act of 2017 have the effect of increasing certain RBC factors, resulting in an overall decrease in insurers' RBC ratios. Also, our statutory capital position has been adversely impacted by the increase in reserves for our Long-Term Care business resulting from our annual reviews and update of assumptions and other refinements (see "—Results of Operations by Segment—Divested and Run-off Businesses" for additional information). Although not yet filed, we expect our RBC ratios as of December 31, 2018 to be above our "AA" financial strength target levels.

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 based on local statutory accounting practices. These solvency margins are a primary measure of the capital adequacy of our international insurance operations. Maintenance of our solvency margins 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.

The table below presents the solvency margin ratios of our most significant international insurance subsidiaries as of September 30, 2018, the most recent date for which this information is available.

| | Ratio | |
|---|---|---|
| Prudential of Japan consolidated(1) | 877 | % |
| Gibraltar Life consolidated(2) | 948 | % |

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(1) Includes Prudential Trust Co., Ltd., a subsidiary of Prudential of Japan.
(2) Includes Prudential Gibraltar Financial Life Insurance Co., Ltd. ("PGFL"), a subsidiary of Gibraltar Life.

Although not yet filed, we expect the solvency margin ratio for each of these subsidiaries to be greater than 700% (3.5 times the regulatory required minimums) as of December 31, 2018.

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All of our domestic and significant international insurance subsidiaries have capital levels that substantially exceed the minimum level required by applicable insurance regulations. Our regulatory capital levels may be affected in the future by changes to the applicable regulations, proposals for which are currently under consideration by both domestic and international insurance regulators. For further information on the calculation of RBC and solvency margin ratios, as well as regulatory minimums, see Note 18 to the Consolidated Financial Statements.

Capital Protection Framework

We employ a Capital Protection Framework (the "Framework") to ensure that sufficient capital resources are available to maintain adequate capitalization on a consolidated basis for our insurance subsidiaries under various stress scenarios. The Framework incorporates the potential impacts from market related stresses, including equity markets, real estate, interest rates, credit losses, and foreign currency exchange rates. In evaluating these potential impacts, we assess risk holistically at the enterprise level, recognizing that our business mix may produce results that partially offset on a net basis. The Framework is integrated with our Risk Management Framework (see "—Risk Management—Risk Measurement and Monitoring" for additional information).

The Framework accommodates periodic volatility within ranges that we deem acceptable, while also providing for additional potential sources of capital, including on-balance sheet capital capacity and contingent sources of capital. We believe we currently have access to sufficient resources to maintain adequate capitalization under a range of potential stress scenarios.

Captive Reinsurance Companies

We use captive reinsurance companies to more effectively manage our reserves and capital on an economic basis and to enable the aggregation and transfer of risks. Our captive reinsurance companies assume business from affiliates only. To support the risks they assume, our captives are capitalized to a level we believe is consistent with the "AA" financial strength rating targets of our insurance subsidiaries. All of our captives are subject to internal policies governing their activities. In the normal course of business we contribute capital to the captives to support business growth and other needs. Prudential Financial has also entered into support agreements with several of the captives in connection with financing arrangements.

Our domestic life insurance subsidiaries are subject to a regulation entitled "Valuation of Life Insurance Policies Model Regulation," commonly known as "Regulation XXX," and a supporting guideline entitled "The Application of the Valuation of Life Insurance Policies Model Regulation," commonly known as "Guideline AXXX." The regulation and supporting guideline require insurers to establish statutory reserves for term and universal life insurance policies with long-term premium guarantees at a level that exceeds what our actuarial assumptions for this business would otherwise require. We use captive reinsurance companies to finance the portion of the reserves for this business that we consider to be non-economic as described below under "—Financing Activities—Subsidiary borrowings—Financing of regulatory reserves associated with domestic life insurance products."

Shareholder Distributions

Share Repurchase Program and Shareholder Dividends

In December 2017, the Board authorized the Company to repurchase at management's discretion up to $1.5 billion of its outstanding Common Stock during the period from January 1, 2018 through December 31, 2018. In December 2018, the Board authorized the Company to repurchase at management's discretion up to $2.0 billion of its outstanding Common Stock during the period from January 1, 2019 through December 31, 2019. The timing and amount of share repurchases are determined by management based on market conditions and other considerations, including any

increased capital needs of our businesses due to, among other things, changes in regulatory capital requirements and opportunities for growth and acquisitions. Repurchases may be executed 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 Securities Exchange Act of 1934.

The following table sets forth information about declarations of Common Stock dividends, as well as repurchases of shares of Prudential Financial's Common Stock, for each of the quarterly periods in 2018 and for the prior four years.

| | Dividend Amount | | Shares Repurchased | |
|---|---|---|---|---|
| Quarterly period ended: | Per Share | Aggregate | Shares | Total Cost |
| | (in millions, except per share data) | | | |
| December 31, 2018 | $0.90 | $ 376 | 4.1 | $ 375 |
| September 30, 2018 | $0.90 | $ 380 | 3.8 | $ 375 |
| June 30, 2018 | $0.90 | $ 382 | 3.7 | $ 375 |
| March 31, 2018 | $0.90 | $ 387 | 3.3 | $ 375 |

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| Year ended: | Dividend Amount Per Share | Dividend Amount Aggregate | Shares Repurchased Shares | Shares Repurchased Total Cost |
|---|---|---|---|---|
| | (in millions, except per share data) | | | |
| December 31, 2018 | $3.60 | $ 1,525 | 14.9 | $ 1,500 |
| December 31, 2017 | $3.00 | $ 1,300 | 11.5 | $ 1,250 |
| December 31, 2016 | $2.80 | $ 1,245 | 25.1 | $ 2,000 |
| December 31, 2015 | $2.44 | $ 1,115 | 12.1 | $ 1,000 |
| December 31, 2014 | $2.17 | $ 1,005 | 11.6 | $ 1,000 |

In addition, on February 6, 2019, the Board declared a cash dividend of $1.00 per share of Common Stock, payable on March 14, 2019 to shareholders of record as of February 20, 2019.

Liquidity

The principles of our liquidity management framework are described in an enterprise-wide Liquidity Management Policy that is reviewed and approved by the Board. Liquidity management and stress testing are performed on a legal entity basis as the ability to transfer funds between subsidiaries is limited due in part to regulatory restrictions. Liquidity needs are determined through daily and quarterly cash flow forecasting at the holding company and within our operating subsidiaries. A minimum balance of highly liquid assets of at least $1.3 billion is targeted to ensure that adequate liquidity is available at Prudential Financial to cover fixed expenses in the event that we experience reduced cash flows from our operating subsidiaries at a time when access to capital markets is also not available. This targeted minimum balance is reviewed and approved annually by the Board.

We seek to mitigate the risk of having limited or no access to financing due to stressed market conditions by generally pre-funding debt in advance of maturity. We mitigate the refinancing risk associated with our debt that is used to fund operating needs by matching the term of debt with the assets financed. To ensure adequate liquidity in stress scenarios, stress testing is performed for our major operating subsidiaries. We seek to further mitigate liquidity risk by maintaining our access to alternative sources of liquidity, as discussed below.

Liquidity of Prudential Financial

The principal sources of funds available to Prudential Financial, the parent holding company, are dividends, returns of capital and loans from subsidiaries, and proceeds from debt issuances and certain stock-based compensation activity. These sources of funds may be supplemented by Prudential Financial’s access to the capital markets as well as the “—Alternative Sources of Liquidity” described below.

The primary uses of funds at Prudential Financial include servicing debt, making capital contributions and loans to subsidiaries, paying declared shareholder dividends and repurchasing outstanding shares of Common Stock executed under authority from the Board.

As of December 31, 2018, Prudential Financial had highly liquid assets with a carrying value totaling $6,199 million. Highly liquid assets predominantly include cash, short-term investments, U.S. Treasury securities, obligations of other U.S. government authorities and agencies, and/or foreign government bonds. We maintain 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. Excluding net borrowings from this intercompany liquidity account, Prudential Financial had highly liquid assets of $5,548 million as of December 31, 2018, an increase of $1,172 million from December 31, 2017.

The following table sets forth Prudential Financial's principal sources and uses of highly liquid assets, excluding net borrowings from our intercompany liquidity account, for the periods indicated.

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| | Year Ended December 31, | |
|---|---|---|
| | 2018 | 2017 |
| | (in millions) | |
| Sources: | | |
| Dividends and/or returns of capital from subsidiaries(1) | $ 4,058 | $ 3,124 |
| Proceeds from the issuance of debt | 2,531 | 743 |
| Proceeds from stock-based compensation and exercise of stock options | 312 | 491 |
| Interest income from subsidiaries on intercompany agreements, net of interest paid | 215 | 230 |
| Net income tax receipts | 231 | 213 |
| Net receipts under intercompany loan agreements(2) | 173 | 190 |
| Total sources | 7,520 | 4,991 |
| Uses: | | |
| Common stock dividends(3) | $ 1,521 | $ 1,296 |
| Share repurchases | 1,500 | 1,250 |
| Capital contributions to subsidiaries(4) | 874 | 1,135 |
| Interest paid on external debt | 890 | 907 |
| Repayments on external debt | 1,443 | 480 |
| Other, net | 120 | 100 |
| Total uses | 6,348 | 5,168 |
| Net increase (decrease) in highly liquid assets | $ 1,172 | $ (177 ) |

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(1) See "Item 15—Schedule II—Notes to Condensed Financial Information of Registrant—Dividends and Returns of Capital" for dividends and returns of capital by company.

(2) 2018 includes net receipts from subsidiaries of $750 million from Gibraltar Universal Life Reinsurance Company, $202 million from PGIM Holding Company and $100 million from Prudential Arizona Reinsurance Universal Company offset by net payments of $623 million to international subsidiaries, $150 million to Dryden Arizona Reinsurance Term Company, $100 million to Prudential Universal Reinsurance Company, and $6 million to other subsidiaries. 2017 includes net receipts from subsidiaries of $1,323 million from international subsidiaries offset by net payments of $500 million to Prudential Universal Reinsurance Company, $350 million to Prudential Arizona Reinsurance Universal Company, $274 million to PGIM Holding Company subsidiaries, and $9 million to other subsidiaries.

(3) Includes cash payments made on dividends declared in prior periods.

(4) 2018 includes capital contributions of $590 million to The Prudential Insurance Company of America ("PICA"), $284 million to international insurance subsidiaries. 2017 includes capital contributions of $965 million to international insurance subsidiaries, $149 million to PICA, and $21 million to PGIM Holding Company subsidiaries.

Restrictions on Dividends and Returns of Capital from Subsidiaries

Our insurance companies are subject to limitations on the payment of dividends and other transfers of funds to Prudential Financial and other affiliates under applicable insurance law and regulation. Also, more generally, 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. See Note 18 to the Consolidated Financial Statements for details on specific dividend restrictions.

Domestic insurance subsidiaries. Prudential Insurance is permitted to pay ordinary dividends based on calculations specified under New Jersey insurance law, subject to prior notification to the New Jersey Department of Banking and Insurance ("NJDOBI"). Any distributions above this amount in any twelve-month period are considered to be "extraordinary" dividends, and the approval of the NJDOBI is required prior to payment. The laws regulating dividends

of the states where our other domestic insurance companies are domiciled are similar, but not identical, to New Jersey's. During 2018, Prudential Financial received extraordinary dividends of $1,025 million from PALAC.

International insurance subsidiaries. Capital redeployment from our international insurance subsidiaries is subject to local regulatory requirements in the international jurisdictions in which they operate. Our most significant international insurance subsidiaries, Prudential of Japan and Gibraltar Life, are permitted to pay common stock dividends based on calculations specified by Japanese insurance law, subject to prior notification to the FSA. Dividends in excess of these amounts and other forms of capital distribution require the prior approval of the FSA. In addition to paying common stock dividends, international insurance operations may return capital to Prudential Financial through or facilitated by other means, such as the repayment of subordinated debt or preferred stock obligations held by Prudential Financial or other affiliates, affiliated lending, affiliated derivatives and reinsurance with U.S.-based affiliates and, commencing in 2019, a Bermuda-based affiliate. The regulatory fiscal year end for both Prudential of Japan and Gibraltar Life is March 31, 2019, after which time the common stock dividend amount permitted to be paid without prior approval from the FSA can be determined.

For the year ended December 31, 2018, Prudential Financial received $2,062 million from Prudential International Insurance Holdings, the domestic parent of our international insurance subsidiaries, all of which was received from Prudential Holdings of Japan, Inc. ("PHJ"), the parent of the Company's Japanese operations. Of this amount, $260 million was sent to PHJ from its

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subsidiaries in 2016 and had been retained at PHJ since that time. PHJ received the remaining $1,802 million as a common stock dividend from its subsidiaries in 2018.

Other subsidiaries. The ability of our investment management subsidiaries and the majority of our other operating subsidiaries to pay dividends is largely unrestricted from a regulatory standpoint.

Liquidity of Insurance Subsidiaries

We manage the liquidity of our insurance operations to ensure stable, reliable and cost-effective sources of cash flows to meet all of our obligations. Liquidity within each of our insurance subsidiaries is provided by a variety of sources, including portfolios of liquid assets. The investment portfolios of our subsidiaries are integral to the overall liquidity of our insurance operations. We segment our investment portfolios and employ an asset/liability management approach specific to the requirements of each 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.

Liquidity is measured against internally-developed benchmarks that take into account the characteristics of both the asset portfolio and the liabilities that they support. 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 our insurance operations' liquidity under various stress scenarios, including company-specific and market-wide events. We continue to believe that cash generated by ongoing operations and the liquidity profile of our assets provide sufficient liquidity under reasonably foreseeable stress scenarios for each of our insurance subsidiaries.

Cash Flow

The principal sources of liquidity for our insurance subsidiaries are premiums, 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 and dividends paid to policyholders, and payments to policyholders and contractholders in connection with surrenders, withdrawals and net policy loan activity. Other uses of liquidity may include commissions, general and administrative expenses, purchases of investments, the payment of dividends to the parent holding company, hedging and reinsurance activity and payments in connection with financing activities.

In each of our major insurance subsidiaries, we believe that the cash flows from operations are adequate to satisfy current liquidity requirements. 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, policyholder behavior, catastrophic events and the relative safety and attractiveness of competing products, each of which could lead to reduced cash inflows or increased cash outflows. Our 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.

Domestic insurance operations. In managing the liquidity of our domestic insurance operations, we 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 the liabilities for future policy benefits and policyholders' account balances of certain of our domestic insurance subsidiaries as of the dates

indicated.

| | December 31, | |
|---|---|---|
| | 2018 | 2017 |
| | (in billions) | |
| Prudential Insurance | $207.0 | $197.9 |
| PLIC | 52.6 | 53.2 |
| Pruco Life | 41.5 | 38.7 |
| PRIAC | 25.8 | 26.4 |
| PALAC | 14.7 | 14.0 |
| Other(1) | (91.0 ) | (87.3 ) |
| Total future policy benefits and policyholders' account balances(2) | $250.6 | $242.9 |

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(1) Includes the impact of intercompany eliminations.

(2) Amounts are reflected gross of affiliated reinsurance recoverables.

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The liabilities presented above are primarily supported by invested assets in our general account. As noted above, when selecting assets to support these contractual obligations, we consider the risk of policyholder and contractholder withdrawals of funds earlier than our assumptions. As a result, assets will include both liquid assets, as discussed below, and other assets that we believe adequately support our liabilities.

For Prudential Insurance and other subsidiaries, the liabilities presented above primarily include annuity reserves and deposit liabilities and individual life insurance policy reserves. Individual life insurance policies may impose surrender charges and policyholders may be subject to a new underwriting process in order to obtain a new insurance policy. Prudential Insurance's reserves for group annuity contracts primarily relate to pension risk transfer contracts, which are generally not subject to early withdrawal. For our individual annuity contracts, to encourage persistency, most of our variable and fixed annuities have surrender or withdrawal charges for a specified number of years. In addition, certain fixed annuities impose a market value adjustment if the invested amount is not held to maturity. The living benefit features of our variable annuities also encourage persistency because the potential value of the living benefit is fully realized only if the contract persists.

For PRIAC, the liabilities presented above primarily include reserves for stable value contracts. Although many of these contracts are subject to discretionary withdrawal, withdrawals are typically at the market value of the underlying assets. Risk is further reduced by the high persistency of clients driven in part by our competitive position in our target markets and contractual provisions such as deferred payouts.

Gross account withdrawals for our domestic insurance operations' products in 2018 were generally consistent with our assumptions in asset/liability management, and the associated cash outflows did not have a material adverse impact on our overall liquidity.

International insurance operations. As with our domestic operations, in managing the liquidity of our international insurance 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 liabilities for future policy benefits and policyholders' account balances of certain of our international insurance subsidiaries as of the dates indicated.

| | December 31, | |
|---|---|---|
| | 2018 | 2017 |
| | (in billions) | |
| Prudential of Japan(1) | $51.6 | $47.1 |
| Gibraltar Life(2) | 104.3 | 99.6 |
| All other international insurance subsidiaries(3) | 17.7 | 15.9 |
| Total future policy benefits and policyholders' account balances(4) | $173.6 | $162.6 |

(1) As of December 31, 2018 and 2017, $13.4 billion and $11.8 billion, respectively, of the insurance-related liabilities for Prudential of Japan are associated with U.S. dollar-denominated products that are coinsured to our domestic insurance operations and supported by U.S. dollar-denominated assets.
(2) Includes PGFL.
(3) Represents our international insurance operations, excluding Japan.
(4) Amounts are reflected gross of affiliated reinsurance recoverables.

The liabilities presented above are primarily supported by invested assets in our general account. When selecting assets to support these contractual obligations, we consider the risk of policyholder and contractholder withdrawals of

funds earlier than our assumptions. As a result, assets will include both liquid assets, as discussed below, and other assets that we believe adequately support our liabilities.

We believe most of 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 to obtain a new insurance policy.

Gibraltar Life sells fixed annuities, denominated in U.S. and Australian dollars, that may be subject to increased surrenders should the yen depreciate in relation to these currencies or if interest rates in Australia and the U.S. decline relative to Japan. A significant portion of the liabilities associated with these contracts include a market value adjustment feature, which mitigates the profitability impact from surrenders. As of December 31, 2018, products with a market value adjustment feature represented $25.9 billion of our Japan operations’ insurance-related liabilities, which included $22.2 billion attributable to non-yen denominated fixed annuities.

Liquid Assets

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Liquid assets include cash and cash equivalents, short-term investments, U.S. Treasury securities, fixed maturities that are not designated as held-to-maturity and public equity securities. In addition to access to substantial investment portfolios, our insurance companies' liquidity is managed through access to 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. Our ability to utilize assets and liquidity between our subsidiaries is limited by regulatory and other constraints. We believe that ongoing operations and the liquidity profile of our assets provide sufficient liquidity under reasonably foreseeable stress scenarios for each of our insurance subsidiaries.

The following table sets forth the fair value of certain of our domestic insurance operations' portfolio of liquid assets, as of the dates indicated.

| | December 31, 2018 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Prudential Insurance | PLIC | PRIAC | PALAC | Pruco Life | Total | December 31, 2017 |
| | (in billions) | | | | | | |
| Cash and short-term investments | $5.0 | $0.9 | $ 0.3 | $ 4.5 | $ 0.4 | $11.1 | $ 11.7 |
| Fixed maturity investments(1): | | | | | | | |
| High or highest quality | 110.7 | 34.8 | 19.2 | 9.6 | 4.9 | 179.2 | 175.1 |
| Other than high or highest quality | 6.6 | 2.4 | 1.4 | 0.5 | 0.4 | 11.3 | 13.8 |
| Subtotal | 117.3 | 37.2 | 20.6 | 10.1 | 5.3 | 190.5 | 188.9 |
| Public equity securities, at fair value | 0.1 | 1.8 | 0.0 | 0.0 | 0.0 | 1.9 | 2.8 |
| Total | $122.4 | $39.9 | $ 20.9 | $ 14.6 | $ 5.7 | $203.5 | $ 203.4 |

(1) Excludes fixed maturities designated as held-to-maturity. Classified by NAIC or equivalent rating.

The following table sets forth the fair value of our international insurance operations' portfolio of liquid assets, as of the dates indicated.

| | December 31, 2018 | | | | |
|---|---|---|---|---|---|
| | Prudential of Japan | Gibraltar Life(1) | All Other(2) | Total | December 31, 2017 |
| | (in billions) | | | | |
| Cash and short-term investments | $0.7 | $ 2.2 | $ 1.2 | $4.1 | $ 4.2 |
| Fixed maturity investments(3): | | | | | |
| High or highest quality(4) | 40.0 | 90.2 | 18.9 | 149.1 | 145.2 |
| Other than high or highest quality | 0.8 | 3.6 | 1.8 | 6.2 | 6.0 |
| Subtotal | 40.8 | 93.8 | 20.7 | 155.3 | 151.2 |
| Public equity securities | 1.7 | 1.6 | 0.7 | 4.0 | 4.5 |
| Total | $43.2 | $ 97.6 | $ 22.6 | $163.4 | $ 159.9 |

(1) Includes PGFL.
(2) Represents our international insurance operations, excluding Japan.
(3) Excludes fixed maturities designated as held-to-maturity. Classified by NAIC or equivalent rating.
(4) As of December 31, 2018, $112.3 billion, or 75%, were invested in government or government agency bonds.

Given the size and liquidity profile of our investment portfolios, we believe that claim experience, including policyholder withdrawals and surrenders, 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, including from changes in interest rates or credit spreads. The 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, in our financial statements. Historically, there has been no significant variation between the expected maturities of our investments and the payment of claims.

Liquidity associated with other activities

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Hedging activities associated with Individual Annuities

For the portion of our Individual Annuities' ALM strategy executed through hedging, as well as the capital hedge program, we enter into a range of exchange-traded, cleared and other OTC equity and interest rate derivatives in order to hedge certain capital market risks related to more severe market conditions. For a full discussion of our Individual Annuities' risk management strategy, see "—Results of Operations by Segment—U.S. Individual Solutions Division—Individual Annuities." This portion of our Individual Annuities' ALM strategy and capital hedge program requires access to liquidity to meet payment obligations relating to these derivatives, such as payments for periodic settlements, purchases, maturities and terminations. These liquidity needs can vary materially due to, among other items, changes in interest rates, equity markets, mortality and policyholder behavior.

The hedging portion of our Individual Annuities' ALM strategy and capital hedge program may also result in derivative related collateral postings to (when we are in a net pay position) or from (when we are in a net receive position) counterparties. The net collateral position depends on changes in interest rates and equity markets related to the amount of the exposures hedged. Depending on market conditions, the collateral posting requirements can result in material liquidity needs when we are in a net pay position. As of December 31, 2018, the derivatives comprising the hedging portion of our ALM strategy and capital hedge program were in a net receive position of $2.9 billion compared to a net receive position of $3.3 billion as of December 31, 2017. The change in collateral position was primarily driven by an increase in interest rates.

Foreign exchange hedging activities

We employ various hedging strategies to manage potential exposure to foreign currency exchange rate movements, particularly those associated with the yen. Our overall yen hedging strategy calibrates the hedge level to preserve the relative contribution of our yen-based business to the Company's overall return on equity on a leverage neutral basis. The hedging strategy includes two primary components:

Income Hedges—We hedge a portion of our prospective yen-based earnings streams by entering into external forward currency derivative contracts that effectively fix the currency exchange rates for that portion of earnings, thereby reducing volatility from foreign currency exchange rate movements. As of December 31, 2018, we have hedged 100%, 72% and 28% of expected yen-based earnings for 2019, 2020 and 2021, respectively.

Equity Hedges—We hold both internal and external hedges primarily to hedge our U.S. dollar-equivalent equity. These hedges also mitigate volatility in the solvency margins of yen-based subsidiaries resulting from changes in the market value of their U.S. dollar-denominated investments hedging our U.S. dollar-equivalent equity attributable to changes in the yen-U.S. dollar exchange rate.

For additional information on our hedging strategy, see "—Results of Operations—Impact of Foreign Currency Exchange Rates."

Cash settlements from these hedging activities result in cash flows between subsidiaries of Prudential Financial and either international-based subsidiaries or external parties. The cash flows are dependent on changes in foreign currency exchange rates and the notional amount of the exposures hedged. For example, a significant yen depreciation over an extended period of time could result in net cash inflows, while a significant yen appreciation could result in net cash outflows. The following tables set forth information about net cash settlements and the net asset or liability resulting from these hedging activities related to the yen and other currencies.

Year ended December 31,

| Cash Settlements: | 2018 | 2017 |
|---|---|---|
| | (in millions) | |
| Income Hedges (External)(1) | $ (13 ) | $ (16 ) |
| Equity Hedges: | | |
| Internal(2) | 105 | 54 |
| External(3) | 246 | (192 ) |
| Total Equity Hedges | $ 351 | $ (138 ) |
| Total Cash Settlements | $ 338 | $ (154 ) |

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| Assets (Liabilities): | As of December 31, 2018 | 2017 |
|---|---|---|
| | (in millions) | |
| Income Hedges (External)(4) | $ 67 | $ (42 ) |
| Equity Hedges: | | |
| Internal(2) | 436 | 623 |
| External(5) | 78 | 303 |
| Total Equity Hedges(6) | $ 514 | $ 926 |
| Total Assets (Liabilities) | $ 581 | $ 884 |

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(1) Includes non-yen related cash settlements of $(11) million, primarily denominated in Korean won and $(14) million, primarily denominated in Brazilian real and Chilean peso, for the year ended December 31, 2018 and 2017, respectively.

(2) Represents internal transactions between international-based and U.S.-based entities. Amounts noted are from the U.S.-based entities' perspectives.

(3) Includes non-yen related cash settlements of $2 million, in Korean won for the year ended December 31, 2018

(4) Includes non-yen related assets of $44 million, primarily denominated in Australian dollar and Brazilian real, and liabilities of $(65) million primarily denominated in Korean won and Australian dollar as of December 31, 2018 and 2017, respectively.

(5) Includes non-yen related liabilities of $(2) million, denominated in Korean won as of December 31, 2018.

(6) As of December 31, 2018, approximately $524 million, $262 million and $(272) million of the net market value is scheduled to settle in 2019, 2020 and thereafter, respectively. The net market value of the assets (liabilities) will vary with changing market conditions to the extent there are no corresponding offsetting positions.

PGIM operations

The principal sources of liquidity for our fee-based PGIM businesses include asset management fees and commercial mortgage origination and servicing fees. The principal uses of liquidity include general and administrative expenses and distributions of dividends and returns of capital to Prudential Financial. The primary liquidity risks for our fee-based PGIM 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 PGIM 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 held in our PGIM businesses are cash flows from investments, the ability to liquidate investments, and available borrowing lines from internal sources, including Prudential Financial and Prudential Funding, LLC ("Prudential Funding"), a wholly-owned subsidiary of Prudential Insurance. The primary liquidity risks include the inability to sell assets in a timely manner, declines in the value of assets and credit defaults. There were no material changes to the liquidity position of our PGIM operations during 2018.

Alternative Sources of Liquidity

In addition to the sources of liquidity discussed above, and asset-based financing as discussed below, Prudential Financial and certain subsidiaries have access to other sources of liquidity, including syndicated, unsecured committed credit facilities, membership in the Federal Home Loan Banks, commercial paper programs, and a put option agreement. See Note 16 to our Consolidated Financial Statements for more information on these sources of liquidity.

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 insurance entities. Investments held in the short-term spread portfolios include cash and cash equivalents, short-term investments (primarily corporate bonds), mortgage loans and fixed maturities (primarily CLOs and other structured securities), with a weighted average life at time of purchase by the short-term portfolios of four years or less. 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.

The following table sets forth our liabilities under asset-based or secured financing programs as of the dates indicated.

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| | December 31, 2018 | | | December 31, 2017 | | |
|---|---|---|---|---|---|---|
| | PFI Excluding Closed Block Division | Closed Block Division | Consolidated | PFI Excluding Closed Block Division | Closed Block Division | Consolidated |
| | ($ in millions) | | | | | |
| Securities sold under agreements to repurchase | $6,982 | $2,968 | $ 9,950 | $4,960 | $3,440 | $ 8,400 |
| Cash collateral for loaned securities | 3,063 | 866 | 3,929 | 3,203 | 1,151 | 4,354 |
| Securities sold but not yet purchased | 9 | 0 | 9 | 3 | 0 | 3 |
| Total(1) | $10,054 | $3,834 | $ 13,888 | $8,166 | $4,591 | $ 12,757 |
| Portion of above securities that may be returned to the Company overnight requiring immediate return of the cash collateral | $3,939 | $983 | $ 4,922 | $3,838 | $1,393 | $ 5,231 |
| Weighted average maturity, in days(2) | 7 | 3 | | 12 | 3 | |

(1) The daily weighted average outstanding balance for the year ended December 31, 2018 and 2017 was $9,653 million and $8,279 million, respectively, for PFI excluding the Closed Block division, and $4,343 million and $4,894 million, respectively, for the Closed Block division.
(2) Excludes securities that may be returned to the Company overnight.

As of December 31, 2018, our domestic insurance entities had assets eligible for the asset-based or secured financing programs of $111.6 billion, of which $14.5 billion were on loan. Taking into account market conditions and outstanding loan balances as of December 31, 2018, we believe approximately $14.2 billion of the remaining eligible assets are readily lendable, including approximately $9.9 billion relating to PFI excluding the Closed Block division, of which $2.3 billion relates to certain separate accounts and may only be used for financing activities related to those accounts, and the remaining $4.3 billion relating to the Closed Block division.

Financing Activities

As of December 31, 2018 and 2017, total short-term and long-term debt of the Company on a consolidated basis was $19.8 billion and $18.6 billion, respectively. 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 actions will depend on prevailing market conditions, our liquidity position and other factors. The following table sets forth total consolidated borrowings of the Company as of the dates indicated.

| | December 31, 2018 | | | December 31, 2017 | | |
|---|---|---|---|---|---|---|
| | Prudential Financial | Subsidiaries | Consolidated | Prudential Financial | Subsidiaries | Consolidated |
| | (in millions) | | | | | |
| General obligation short-term debt: | | | | | | |
| Commercial paper | $15 | $ 727 | $ 742 | $50 | $ 500 | $ 550 |
| Current portion of long-term debt | 1,100 | 499 | 1,599 | 830 | 0 | 830 |
| Subtotal | 1,115 | 1,226 | 2,341 | 880 | 500 | 1,380 |
| General obligation long-term debt: | | | | | | |
| Senior debt | 8,630 | 173 | 8,803 | 8,738 | 173 | 8,911 |
| Junior subordinated debt | 7,511 | 57 | 7,568 | 6,566 | 56 | 6,622 |
| Surplus notes (1) | 0 | 341 | 341 | 0 | 840 | 840 |
| Subtotal | 16,141 | 571 | 16,712 | 15,304 | 1,069 | 16,373 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Total general obligations | 17,256 | 1,797 | 19,053 | 16,184 | 1,569 | 17,753 |
| Limited and non-recourse borrowings (2) | | | | | | |
| Short-term debt | 0 | 53 | 53 | 0 | 0 | 0 |
| Current portion of long-term debt | 0 | 57 | 57 | 0 | 0 | 0 |
| Long-term debt | 0 | 666 | 666 | 0 | 799 | 799 |
| Subtotal | 0 | 776 | 776 | 0 | 799 | 799 |
| Total borrowings | $17,256 | $ 2,573 | $ 19,829 | $16,184 | $ 2,368 | $ 18,552 |

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(1) Amounts are net of assets under set-off arrangements of $9,095 million and $7,287 million as of December 31, 2018 and 2017, respectively.

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(2) Limited and non-recourse borrowing represents mortgage debt of our subsidiaries that has recourse only to real estate investment property.

As of December 31, 2018 and 2017, we were in compliance with all debt covenants related to the borrowings in the table above. For further information on our short- and long-term debt obligations, see Note 16 to our Consolidated Financial Statements.

Based on the use of proceeds, we classify our borrowings as capital debt, investment-related debt, and debt related to specified businesses. Capital debt, which is debt utilized to meet the capital requirements of our businesses, was $13.4 billion and $12.0 billion as of December 31, 2018 and 2017, respectively. Investment-related debt of $3.9 billion and $4.0 billion as of December 31, 2018 and 2017, respectively, consists of debt issued to finance specific investment assets or portfolios of investment assets, the proceeds from which will service the debt. Specifically, this includes institutional spread lending investment portfolios, assets supporting reserve requirements under Regulation XXX and Guideline AXXX as described below, as well as funding for institutional and insurance company portfolio cash flow timing differences. Our remaining borrowings are utilized for business funding to meet specific purposes, which may include funding new business acquisition costs associated with our individual annuities business, operating needs associated with hedging our individual annuities products as discussed above and activities associated with our investment management business.

Prudential Financial Borrowings

Long-term borrowings are conducted primarily by Prudential Financial. It borrows these funds to meet its capital and other funding needs, as well as the capital and funding needs of its subsidiaries. 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 and has no stated issuance capacity.

Prudential Financial’s borrowings increased $1.1 billion from December 31, 2017, driven by the issuance of $1.5 billion of junior subordinated debt and $1 billion of senior debt, partially offset by senior debt maturities of $0.7 billion, redemption of $0.6 billion of junior subordinated debt, and $0.1 billion of retail note maturities. For more information on long-term debt, see Note 16 to our Consolidated Financial Statements.

Subsidiary Borrowings

Subsidiary borrowings principally consist of commercial paper borrowings by Prudential Funding, asset-based financing and real estate investment financing. Borrowings of our subsidiaries increased $0.2 billion from December 31, 2017 due to an increase in commercial paper outstanding.

Term and Universal Life Reserve Financing

Regulation XXX and Guideline AXXX require domestic life 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 policies with similar guarantees. Many market participants believe that these levels of reserves are excessive relative to the levels reasonably required to maintain solvency for moderately adverse experience. The difference between the statutory reserve and the amount necessary to maintain solvency for moderately adverse experience is considered to be the non-economic portion of the statutory reserve.

We use captive reinsurance subsidiaries to finance the portion of the statutory reserves required to be held by our domestic life insurance companies under Regulation XXX and Guideline AXXX that we consider to be

non-economic. The financing arrangements involve the reinsurance of term and universal life business to our captive reinsurers and the issuance of surplus notes by those captives that are treated as capital for statutory purposes. These surplus notes are subordinated to policyholder obligations, and the payment of principal and interest on the surplus notes can only be made with prior insurance regulatory approval.

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We have entered into agreements with external counterparties providing for the issuance of surplus notes by our captive reinsurers in return for the receipt of credit-linked notes ("Credit-Linked Note Structures"). As of December 31, 2018, we had Credit-Linked Note Structures with an aggregate issuance capacity of $13,750 million, of which $11,445 million was outstanding, as compared to an aggregate issuance capacity of $11,100 million, of which $9,487 million was outstanding, as of December 31, 2017. Under the agreements, the captive receives in exchange for the surplus notes one or more credit-linked notes issued by a special-purpose affiliate of the Company with an aggregate principal amount equal to the surplus notes outstanding. The captive holds the credit-linked notes as assets supporting Regulation XXX or Guideline AXXX non-economic reserves, as applicable. The captive can redeem the principal amount of the outstanding credit-linked notes for cash upon the occurrence of, and in an amount necessary to remedy, a specified liquidity stress event affecting the captive. Under the agreements, the external counterparties have agreed to fund any such payments under the credit-linked notes in return for the receipt of fees. Under certain of the transactions, Prudential Financial has agreed to make capital contributions to the captive to reimburse it for investment losses in excess of specified amounts and/or has agreed to reimburse the external counterparties for any payments made under the credit-linked notes. To date, no such payments under the credit-linked notes have been required. Under these transactions, because valid rights of set-off exist, interest and principal payments on the surplus notes and on the credit-linked notes are settled on a net basis, and the surplus notes are reflected in the Company's total consolidated borrowings on a net basis.

The following table summarizes our Credit-Linked Note Structures, which are reported on a net basis, as of December 31, 2018.

| Credit-Linked Note Structures: | Surplus Notes Original Issue Dates | Surplus Notes Maturity Dates | Outstanding as of December 31, 2018 | | Facility Size |
|---|---|---|---|---|---|
| | ($ in millions) | | | | |
| XXX | 2011-2014 | 2021-2024 | $1,750 | (1) | $1,750 |
| AXXX | 2013 | 2033 | 3,129 | | 3,500 |
| XXX | 2014-2018 | 2021-2034 | 2,350 | (2) | 2,500 |
| XXX | 2014-2017 | 2024-2037 | 2,200 | | 2,400 |
| AXXX | 2017 | 2037 | 1,466 | | 2,000 |
| XXX | 2018 | 2038 | 550 | | 1,600 |
| Total Credit-Linked Note Structures | | | $11,445 | | $13,750 |

(1) Prudential Financial has agreed to reimburse any amounts paid under the credit-linked notes issued in this structure.

(2) The $2.35 billion of surplus notes represents an intercompany transaction that eliminates upon consolidation. Prudential Financial has agreed to reimburse amounts paid under credit-linked notes issued in this structure up to $1.0 billion.

As of December 31, 2018, we also had outstanding an aggregate of $2.3 billion of debt issued for the purpose of financing Regulation XXX and Guideline AXXX non-economic reserves, of which approximately $0.6 billion relates to Regulation XXX reserves and approximately $1.7 billion relates to Guideline AXXX reserves. In addition, as of December 31, 2018, for purposes of financing Guideline AXXX reserves, one of our captives had approximately $4.0 billion of surplus notes outstanding that were issued to affiliates.

The Company has introduced updated versions of several products in its individual life product portfolio in conjunction with the requirement to adopt principle-based reserving by January 1, 2020. Notably, the Company

adopted principle-based reserving for its guaranteed universal life products and introduced updated versions of these products in 2017. The guaranteed universal life updated products support the principle-based statutory reserve level without the need for financing through captive reinsurance. The Company is continuing to assess the impact of principle-based reserving on projected statutory reserve levels and product pricing for its remaining portfolio of individual life product offerings.

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. Our credit ratings are also important for our ability to raise capital through the issuance of debt and for the cost of such financing. 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.

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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) |
|---|---|---|---|---|
| Last review date | 12/13/2018 | 11/20/2018 | 11/15/2017 | 10/18/2018 |
| Current outlook | Stable | Stable* | Positive | Stable |
| Financial Strength Ratings: | | | | |
| The Prudential Insurance Company of America | A+ | AA- | A1 | AA- |
| Pruco Life Insurance Company | A+ | AA- | A1 | AA- |
| Pruco Life Insurance Company of New Jersey | A+ | AA- | NR** | AA- |
| Prudential Annuities Life Assurance Corporation | A+ | AA- | NR | AA- |
| Prudential Retirement Insurance and Annuity Company | A+ | AA- | A1 | AA- |
| The Prudential Life Insurance Company Ltd. (Prudential of Japan) | NR | A+ | NR | NR |
| Gibraltar Life Insurance Company, Ltd. | NR | A+ | NR | NR |
| The Prudential Gibraltar Financial Life Insurance Co. Ltd | NR | A+ | NR | NR |
| Prudential Life Insurance Co. of Taiwan, Inc.(5) | NR | twAAA | NR | NR |
| Credit Ratings: | | | | |
| Prudential Financial, Inc.: | | | | |
| Short-term borrowings | AMB-1 | A-1 | P-2 | F1 |
| Long-term senior debt | a- | A | Baa1 | A- |
| Junior subordinated long-term debt | bbb | BBB+ | Baa2 | BBB |
| The Prudential Insurance Company of America: | | | | |
| Capital and surplus notes | a | A | A3 | A |
| Prudential Funding, LLC: | | | | |
| Short-term debt | AMB-1 | A-1+ | P-1 | F1+ |
| Long-term senior debt | a+ | AA- | A2 | A+ |
| PRICOA Global Funding I: | | | | |
| Long-term senior debt | aa- | AA- | A1 | AA- |

* The Current 'Stable' Outlook on Prudential's ratings corresponds to all S&P rated Prudential entities except for Prudential's Japanese Subsidiaries (The Prudential Life Insurance Company Ltd., Gibraltar Life Insurance Company, Ltd., and The Prudential Gibraltar Financial Life Insurance Co. Ltd.), which have 'Positive' Outlooks.

** "NR" indicates not rated.

(1) A.M. Best Company, which we refer to as A.M. Best, financial strength ratings for insurance companies range from "A++ (superior)" to "D (Poor)". A rating of A+ is the second highest of thirteen rating categories. A.M. Best

long-term credit ratings range from “aaa (exceptional)” to “c (Poor)”. A.M. Best short-term credit ratings range from “AMB-1+”, which represents the strongest ability to repay short-term debt obligations, to “AMB-4 (Questionable)”.

(2) Standard & Poor’s Rating Services, which we refer to as S&P, financial strength ratings for insurance companies range from “AAA (extremely strong)” to “D (default)”. A rating of AA- is the fourth highest of twenty-three rating categories. 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 range from “Aaa (exceptional)” to “C (lowest)”. A rating of A1 is the fifth highest of twenty-one rating categories. 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 long-term credit ratings range from “Aaa (highest)” to “C (default)”. Moody’s short-term ratings range from “Prime-1 (P-1)”, which represents a superior ability for repayment of 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 Inc., which we refer to as Fitch, financial strength ratings range from “AAA (exceptionally strong)” to “C (distressed)”. A rating of AA- is the fourth highest of twenty-one rating categories. Fitch long-term credit ratings range from “AAA (highest credit quality)”, which denotes exceptionally strong capacity for timely payment of financial commitments, to “D (default)”. Short-term ratings range from “F1+ (highest credit quality)” to “D (default)”.

(5) This rating for Prudential Life Insurance Company of Taiwan, Inc. was upgraded to “twAAA” from “twAA+” in November of 2018 by Taiwan Ratings Corporation, an S&P Global Company.

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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 stakeholders that we will maintain our current ratings in the future.

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 to 18 months the rating agency expects ratings to remain unchanged among companies in the sector. In 2018, A.M. Best revised the Rating Outlook on the U.S. life insurance industry from Negative to Stable. Fitch, Moody's, and S&P maintained their outlook for the U.S. life insurance sector at Stable. 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. A.M. Best, Fitch, and S&P have the Company's ratings on Stable outlook. Moody's has the ratings of Prudential Financial and its insurance subsidiaries on Positive outlook.

The following is a summary of the significant changes or actions in ratings and rating outlooks for our Company, as well as for the life insurance industry and sector, that have occurred from January 1, 2018 through the date of this filing:

In April 2018, S&P revised the company outlook for Prudential of Japan, Gibraltar Life and PGFL from Stable to Positive, which resulted from S&P's revised outlook on the Japan sovereign credit rating from Stable to Positive.

In November 2018, Prudential Life Insurance Co. of Taiwan's Issuer Credit Rating and Financial Strength Rating was upgraded from "twAA+" to "twAAA" by Taiwan Rating Corp., an S&P Global Company. This upgrade reflects the revised assessment of Prudential Taiwan's increased importance to Prudential Financial, from "strategically important" to "highly strategic".

Requirements to post collateral or make other payments because 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. In addition, a ratings downgrade by A.M. Best to "A-" for our domestic life insurance companies would require Prudential Insurance to either post collateral or a letter of credit in the amount of approximately $1.4 billion, based on the level of statutory reserves related to the variable annuity business acquired from Allstate. We believe that the posting of such collateral would not be a material liquidity event for Prudential Insurance.

Contractual Obligations

The table below summarizes the future estimated cash payments related to certain contractual obligations as of December 31, 2018. The estimated payments reflected in this table are based on management's estimates and assumptions about these obligations. Because these estimates and assumptions are necessarily subjective, the actual cash outflows in future periods will vary, possibly materially, from those reflected in the table. In addition, we do not believe that our cash flow requirements can be adequately assessed based solely upon an analysis of these obligations, as the table below does not contemplate all aspects of our cash inflows, such as the level of cash flow generated by certain of our investments, nor all aspects of our cash outflows.

| | Estimated Payments Due by Period | | | |
|---|---|---|---|---|
| | Total | 2019 | 2020-2021 | 2022-2023 |

| | | | | | 2024 and thereafter |
|---|---|---|---|---|---|
| | (in millions) | | | | |
| Short-term and long-term debt obligations(1) | $39,905 | $3,420 | $ 3,690 | $ 1,969 | $30,826 |
| Operating and capital lease obligations(2) | 685 | 168 | 239 | 140 | 138 |
| Purchase obligations: | | | | | |
| Commitments to purchase or fund investments(3) | 7,088 | 4,020 | 1,833 | 868 | 367 |
| Commercial mortgage loan commitments(4) | 3,299 | 3,166 | 133 | 0 | 0 |
| Other liabilities: | | | | | |
| Insurance liabilities(5) | 1,142,301 | 44,161 | 66,657 | 66,945 | 964,538 |
| Other(6) | 14,035 | 13,906 | 76 | 53 | 0 |
| Total | $1,207,313 | $68,841 | $ 72,628 | $ 69,975 | $995,869 |

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(1) The estimated payments due by period for long-term debt reflects the contractual maturities of principal, as disclosed in Note 16 to the Consolidated Financial Statements, as well as estimated future interest payments. The payment of principal and estimated future interest for short-term debt are reflected in estimated payments due in 2019. The estimate for future interest payments includes the effect of derivatives that qualify for hedge accounting treatment. See Note 16 to the Consolidated Financial Statements for additional information concerning our short-term and long-term debt.

(2) The estimated payments due by period for operating and capital leases reflect the future minimum lease payments under non-cancelable operating and capital leases, as disclosed in Note 22 to the Consolidated Financial Statements.

(3) As discussed in Note 22 to the Consolidated Financial Statements, we have commitments to purchase or fund investments, some of which are contingent upon events or circumstances not under our control, including those at the discretion of our counterparties. The timing of the fulfillment of certain of these commitments cannot be estimated, therefore the settlements of these obligations are reflected in estimated payments due in less than one year. Commitments to purchase or fund investments include $147 million that we anticipate will ultimately be funded from our separate accounts.

(4) As discussed in Note 22 to the Consolidated Financial Statements, loan commitments of our commercial mortgage operations, which are legally binding commitments to extend credit to a counterparty, have been reflected in the contractual obligations table above principally based on the expiration date of the commitment; however, it is possible these loan commitments could be funded prior to their expiration date. In certain circumstances the counterparty may also extend the date of the expiration in exchange for a fee.

(5) The estimated cash flows due by period for insurance liabilities reflect future estimated cash payments to be made to policyholders and others for future policy benefits, policyholders' account balances, policyholder's dividends, reinsurance payables and separate account liabilities, net of premium receipts and reinsurance recoverables. These future estimated cash flows for current policies in force generally reflect our best estimate economic and actuarial assumptions. These cash flows are undiscounted with respect to interest. The sum of the cash flows shown for all years in the table of $1,142 billion exceeds the corresponding liability amounts of approximately $711 billion included in the Consolidated Financial Statements as of December 31, 2018. Separate account liabilities are legally insulated from general account obligations, and it is generally expected these liabilities will be fully funded by separate account assets and their related cash flows. We have made significant assumptions to determine the future estimated cash flows related to the underlying policies and contracts. Due to the significance of the assumptions used, actual cash flows will differ, possibly materially, from these estimates.

(6) The estimated payments due by period for other liabilities includes securities sold under agreements to repurchase, cash collateral for loaned securities, liabilities for unrecognized tax benefits, bank customer liabilities, and other miscellaneous liabilities. Amounts presented in the table also exclude $955 million of notes issued by consolidated VIE's which recourse for these obligations is limited to the assets of the respective VIE and do not have recourse to the general credit of the company.

We also enter into agreements to purchase goods and services in the normal course of business; however, these purchase obligations are not material to our consolidated results of operations or financial position as of December 31, 2018.

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 which we may be contingently required to make payments in the future. See Note 22 to the 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 Note 22 to the 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 associated with other activities—PGIM operations."

Other Off-Balance Sheet Arrangements

In 2013, we entered into a put option agreement with a Delaware trust that gives Prudential Financial the right, at any time over a ten-year period, to issue up to $1.5 billion of senior notes to the trust in return for principal and interest strips of U.S. Treasury securities that are held by the trust. See Note 16 to our Consolidated Financial Statements for more information on this put option agreement. In 2014, Prudential Financial entered into financing transactions, pursuant to which it issued $500 million of limited recourse notes and, in return, obtained $500 million of asset-backed notes from a Delaware master trust and ultimately contributed the asset-backed notes to its subsidiary, PRIAC. As of December 31, 2018, no principal payments have been received or are currently due on the asset-backed notes and, as a result, there was no payment obligation under the limited recourse notes. Accordingly, none of the notes are reflected in the Company’s Consolidated Financial Statements as of that date.

Other than as described above, we do not have retained or contingent interests in assets transferred to unconsolidated entities, or variable interests in unconsolidated entities or other similar transactions, arrangements or relationships that serve as credit, liquidity or market risk support, that we believe are reasonably likely to have a material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or our access to or requirements for capital resources. In addition, other than the agreements referred to above, 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.

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## Risk Management

### Overview

We employ a risk governance structure, overseen by senior management and our Board and managed by Enterprise Risk Management ("ERM"), to provide a common framework for evaluating the risks embedded in and across our businesses and corporate centers, developing risk appetites, managing these risks and identifying current and future risk challenges and opportunities. For a discussion of the risks of our businesses, see "Risk Factors".

### Risk Governance Framework

Each of our businesses has a risk governance structure that is supported by a framework at the corporate level. Generally, our businesses are authorized to make day-to-day risk decisions that are consistent with enterprise risk policies and limits, and subject to enterprise oversight. Our governance structure is comprised of the Board and its committees, management committees and ERM and is designed to support this framework.

### Board of Directors Oversight

Our Board oversees our risk profile and management's processes for assessing and managing risk. The Board also reviews strategic risks and opportunities facing the Company. Certain specific categories of risk are assigned to Board committees that report back to the full Board, as summarized below:

- Audit Committee: oversees insurance risk and operational risks, including model risk, as well as risks related to financial controls, legal, regulatory and compliance risks, and the overall risk management governance structure and risk management function.
- Compensation Committee: oversees our compensation programs so that incentives are aligned with appropriate risk taking.
- Corporate Governance and Business Ethics Committee: oversees our corporate governance procedures and practices, ethics and conflict of interest policies, political contributions, lobbying expenses and overall political strategy, as well as our strategy and reputation regarding environmental stewardship, sustainability and corporate social responsibility.
- Finance Committee: oversees liquidity risk, including risks involving our capital and liquidity management, the incurrence and repayment of borrowings, the capital structure, the funding of benefit plans and statutory insurance reserves. The Finance Committee reviews and recommends for approval to the Board our capital plan. The Finance Committee also receives regular updates on the sources and uses of capital relative to plan, as well as on our Capital Protection Framework.
- Investment Committee: oversees investment risk and market risk and the strength of the investment function. The Investment Committee approves investment and market risk limits based on asset class, issuer, credit quality and geography.
- Risk Committee: oversees the governance of significant risks throughout the Company and the establishment and ongoing monitoring of our risk profile, risk capacity and risk appetite. The Risk Committee also serves to coordinate the risk oversight functions of the other committees of the Board.

### Management Oversight

Our primary risk management committee is the Enterprise Risk Committee ("ERC"). Currently, the ERC is chaired by our Chief Risk Officer and otherwise comprised of the Vice Chairman, Chief Operating Officers for the U.S. and International Businesses, General Counsel, Chief Financial Officer, Chief Investment Officer and Chief Actuary. Our Chief Auditor also attends meetings of the ERC. The ERC's mandate is to review significant risks that impact us and approve, or recommend to the Board for approval, our risk management policies and limits to keep our risk profile

consistent with our strategy.

The ERC is supported by six Risk Oversight Committees aligned with our tactical risks, each of which is comprised of subject matter experts and dedicated to one of the following risk types: investment, market, insurance, operational, model and liquidity. These Risk Oversight Committees report their activities to the ERC, and significant matters or matters where there are unresolved points of view are reviewed and brought to the ERC. The Risk Oversight Committees provide an opportunity to evaluate complex issues by subject matter experts within the various risk areas. They evaluate the adequacy and effectiveness of risk mitigation options, identify stakeholders of risks and issues, review material assumptions for reasonability and consistency across the Company and, working with the different risk areas, develop recommendations for risk limits, among other responsibilities.

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Each of our businesses and significant corporate centers maintains its own risk committee. The business risk committees serve as a forum for leaders within each business to identify, assess and resolve risk and exposure issues and to review new products and initiatives, prior to such issues being reviewed by the Risk Oversight Committees and/or the ERC as appropriate. Corporate center risk committees assess and monitor risks associated with the relevant corporate centers, set standards and exercise oversight over specific risks.

Enterprise Risk Management Oversight

ERM manages a comprehensive framework for assessing the risks embedded in and across our businesses so that the Company can manage these risks effectively, evaluate current and future risk challenges and opportunities, and enhance shareholder value. ERM operates independently and is responsible for recommending policies, limits and standards for all risks. It oversees these risks under the guidance of the ERC and Risk Oversight Committees. Additionally, ERM works with our businesses and corporate centers with an objective of comprehensive identification, monitoring and management of risks that we may face. The ERM infrastructure is generally aligned by risk type, with certain groups within ERM working across risk types.

Risk Identification

We rely on a combination of activities and processes to provide analysis and seek assurance that all material risks have been identified and managed as appropriate. There are three levels of activities that seek to ensure that changes in risk levels or new risks to the Company are identified and escalated as appropriate: (1) business activities, (2) corporate center activities, and (3) processes involving senior management and the Board.

- Businesses: Each business area has a risk committee that meets periodically to allow senior leaders to discuss and evaluate current, new, and anticipatory risks in their own operations. Businesses are required to develop and maintain documented operational risk inventories which facilitate the identification of current operational risk exposures. Anticipatory risks are identified, assessed and monitored for potential future risks which could significantly impact the businesses or the overall Company.
- Corporate Centers: The corporate centers review the results of the business activities and examine risks from an enterprise view across businesses under normal and stressed conditions. As a result, the corporate centers, particularly ERM, use several processes and activities to identify and assess the risks of the Company.
- Senior Management and the Board: Senior management plays a critical role in reviewing the risk profile of the Company, including by identifying impacts to the business strategy of new or changed risks, and risks in any new strategies under consideration. These risks are discussed with the ERC as appropriate, and with the Board, if significant. As discussed above, the Board oversees the Company’s risk profile and management’s processes for assessing and managing risk, both as a full Board and through its committees.

Risk Measurement and Monitoring

Our Risk Appetite Framework (“RAF”) is a comprehensive process designed to reasonably ensure that all risks taken across the Company align with the Company’s capacity and willingness to take those risks. Using common metrics allows for a cohesive assessment of risk, resources and strategy, and supports management and the Board in making well-informed business decisions. The Company has a comprehensive stress testing framework, which serves as the foundation for the RAF. The RAF evaluates the Company’s exposure under various stress metrics and stress severities. The RAF provides a dynamic assessment of stress impacts and resources available to absorb these impacts under comprehensive stress scenarios. The Company’s capital management framework is integrated with the RAF to determine the amount of capital the Company needs to hold given the risks taken.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

### Market Risk

Market risk is defined as the risk of loss from changes in interest rates, equity prices and foreign currency exchange rates resulting from asset/liability mismatches where the change in the value of our liabilities is not offset by the change in value of our assets.

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For additional information regarding the potential impacts of interest rate and other market fluctuations, as well as general economic and market conditions on our businesses and profitability, see Item 1A. "Risk Factors" above. For additional information regarding the overall management of our general account investments and our asset mix strategies, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—General Account Investments—Management of Investments" above. For additional information regarding our liquidity and capital resources, which may be impacted by changing market risks, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources" above.

Market Risk Management

Management of market risk, which we consider to be a combination of both investment risk and market risk exposures, includes the identification and measurement of various forms of risk, the establishment of risk thresholds and the creation of processes intended to maintain risks within these thresholds while optimizing returns on the underlying assets or liabilities.

Our risk management process utilizes a variety of tools and techniques, including:

- Measures of price sensitivity to market changes (e.g., interest rates, equity index prices, foreign exchange);
- Asset/liability management;
- Stress scenario testing;
- Hedging programs; and
- Risk management governance, including policies, limits, and a committee that oversees investment and market risk.

For additional information regarding our overall risk management framework and governance structure, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Risk Management" above.

Market Risk Mitigation

Risk mitigation takes three primary forms:

- Asset/Liability Management: Managing assets to liability-based measures. For example, investment policies identify target durations for assets based on liability characteristics and asset portfolios are managed to within ranges around them. This mitigates potential unanticipated economic losses from interest rate movements.
- Hedging: Using derivatives to offset risk exposures. For example, for our variable annuities, potential living benefit claims resulting from more severe market conditions are hedged using derivative instruments.
- Management of portfolio concentration risk. For example, ongoing monitoring and management at the enterprise level of key rate, currency and other concentration risks support diversification efforts to mitigate exposure to individual markets and sources of risk.

Market Risk Related to Interest Rates

We perform liability-driven investing and engage in careful asset/liability management. Asset/liability mismatches create the risk that changes in liability values will differ from the changes in the value of the related assets. Additionally, changes in interest rates may impact other items including, but not limited to, the following:

- Net investment spread between the amounts that we are required to pay and the rate of return we are able to earn on investments for certain products supported by general account investments;
- Asset-based fees earned on assets under management or contractholder account values;
- Estimated total gross profits and the amortization of deferred policy acquisition and other costs;
- Net exposure to the guarantees provided under certain products; and

• Capital levels of our regulated entities.

We use duration and convexity analyses to measure price sensitivity to interest rate changes. Duration measures the relative sensitivity of the fair value of a financial instrument to changes in interest rates. Convexity measures the rate of change of duration with respect to changes in interest rates. We use asset/liability management and derivative strategies to manage our interest rate exposure by legal entity by matching the relative sensitivity of asset and liability values to interest rate changes, or controlling “duration mismatch” of assets and liability duration targets. In certain markets, capital market limitations that hinder our ability to acquire assets that approximate the duration of some of our liabilities are considered in setting duration targets. We consider risk-based capital and tax implications as well as current market conditions in our asset/liability management strategies.

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We assess the impact of interest rate movements on the value of our financial assets, financial liabilities and derivatives using hypothetical test scenarios that assume either upward or downward 100 basis point parallel shifts in the yield curve from prevailing interest rates, reflecting changes in either credit spreads or the risk-free rate. The following table sets forth the net estimated potential loss in fair value on these financial instruments from a hypothetical 100 basis point upward shift as of December 31, 2018 and 2017. This table is presented on a gross basis and excludes offsetting impacts to insurance liabilities that are not considered financial liabilities under U.S GAAP. This scenario results in the greatest net exposure to interest rate risk of the hypothetical scenarios tested at those dates. While the test scenario is for illustrative purposes only and does not reflect our expectations regarding future interest rates or the performance of fixed income markets, it is a near-term, reasonably possible hypothetical change that illustrates the potential impact of such events. These test scenarios do not measure the changes in value that could result from non-parallel shifts in the yield curve which we would expect to produce different changes in discount rates for different maturities. As a result, the actual loss in fair value from a 100 basis point change in interest rates could be different from that indicated by these calculations. The estimated changes in fair values do not include separate account assets.

| | As of December 31, 2018 | | | As of December 31, 2017 | | |
|---|---|---|---|---|---|---|
| | Notional | Fair Value | Hypothetical Change in Fair Value | Notional | Fair Value | Hypothetical Change in Fair Value |
| | (in millions) | | | | | |
| Financial assets with interest rate risk: | | | | | | |
| Fixed maturities(1) | | $378,850 | $ (37,691) | | $372,926 | $ (36,554) |
| Commercial mortgage and other loans | | 59,978 | (2,936) | | 57,341 | (2,832) |
| Derivatives with interest rate risk: | | | | | | |
| Swaps | $201,872 | 5,164 | (4,455) | $210,137 | 4,735 | (3,824) |
| Futures | 15,139 | 13 | (778) | 24,502 | 24 | (1,081) |
| Options | 83,198 | (337) | 387 | 54,522 | 188 | 188 |
| Forwards | 26,220 | 230 | (256) | 25,948 | (94) | 0 |
| Synthetic GICs | 79,215 | 2 | 0 | 77,290 | (1) | (1) |
| Variable annuity and other living benefit feature embedded derivatives(2) | | (8,926) | 5,030 | | (8,720) | 5,706 |
| Financial liabilities with interest rate risk(3): | | | | | | |
| Short-term and long-term debt | | (20,484) | 3,095 | | (21,144) | 3,180 |
| Policyholders' account balances—investment contracts | | (98,428) | 3,367 | | (100,186) | 3,561 |
| Net estimated potential loss | | | $ (34,237) | | | $ (31,657) |

(1) Includes assets classified as "Fixed maturities, available-for-sale, at fair value," "Assets supporting experience-rated contractholder liabilities, at fair value" and "Fixed maturities, trading, at fair value." Approximately $354 billion and $370 billion as of December 31, 2018 and 2017, respectively, of fixed maturities are classified as available-for-sale.

(2) Excludes any offsetting impact of derivative instruments purchased to hedge changes in the embedded derivatives. Amounts reported net of third-party reinsurance.

(3) Excludes approximately $324 billion and $306 billion as of December 31, 2018 and 2017, respectively, of insurance reserve and deposit liabilities which are not considered financial liabilities. We believe that the interest rate sensitivities of these insurance liabilities would serve as an offset to the net interest rate risk of the financial assets and liabilities, including investment contracts.

Under U.S. GAAP, the fair value of the embedded derivatives for certain variable annuity and other living benefit features, reflected in the table above, includes the impact of the market's perception of our NPR. For more information on NPR related to the sensitivity of the embedded derivatives to our NPR credit spread, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Accounting Policies & Pronouncements—Application of Critical Accounting Estimates—Sensitivities for Insurance Assets and Liabilities" above.

For an additional discussion of our variable annuity optional living benefit guarantees accounted for as embedded derivatives and related derivatives used to hedge the changes in fair value of these embedded derivatives, see "Market Risk Related to Certain Variable Annuity Products" below. For additional information about the key estimates and assumptions used in our determination of fair value, see Note 6 to the Consolidated Financial Statements. For information on the impacts of a sustained low interest rate environment, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Executive Summary—Impact of a Low Interest Rate Environment" above.

Market Risk Related to Equity Prices

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We have exposure to equity risk through asset/liability mismatches, including our investments in equity securities held in our general account investment portfolio and unhedged exposure in our insurance liabilities, principally related to certain variable annuity living benefit feature embedded derivatives. Our equity-based derivatives primarily hedge the equity risk embedded in these living benefit feature embedded derivatives, and are also part of our capital hedging program. Changes in equity prices create risk that the resulting changes in asset values will differ from the changes in the value of the liabilities relating to the underlying or hedged products. Additionally, changes in equity prices may impact other items including, but not limited to, the following:

- Asset-based fees earned on assets under management or contractholder account value;
- Estimated total gross profits and the amortization of deferred policy acquisition and other costs; and
- Net exposure to the guarantees provided under certain products.

We manage equity risk against benchmarks in respective markets. We benchmark our return on equity holdings against a blend of market indices, mainly the S&P 500 and Russell 2000 for U.S. equities. We benchmark foreign equities against the Tokyo Price Index, and the MSCI EAFE, a market index of European, Australian, and Far Eastern equities. We target price sensitivities that approximate those of the benchmark indices.

We estimate our equity risk from a hypothetical 10% decline in equity benchmark market levels. The following table sets forth the net estimated potential loss in fair value from such a decline as of December 31, 2018 and 2017. While these scenarios are for illustrative purposes only and do not reflect our expectations regarding future performance of equity markets or of our equity portfolio, they represent near-term reasonably possible hypothetical changes that illustrate the potential impact of such events. These scenarios consider only the direct impact on fair value of declines in equity benchmark market levels and not changes in asset-based fees recognized as revenue, changes in our estimates of total gross profits used as a basis for amortizing deferred policy acquisition and other costs, or changes in any other assumptions such as market volatility or mortality, utilization or persistency rates in our variable annuity contracts that could also impact the fair value of our living benefit features. In addition, these scenarios do not reflect the impact of basis risk, such as potential differences in the performance of the investment funds underlying the variable annuity products relative to the market indices we use as a basis for developing our hedging strategy. The impact of basis risk could result in larger differences between the change in fair value of the equity-based derivatives and the related living benefit features in comparison to these scenarios. In calculating these amounts, we exclude separate account equity securities.

| | As of December 31, 2018 | | | As of December 31, 2017 | | |
|---|---|---|---|---|---|---|
| | Notional | Fair Value | Hypothetical Change in Fair Value | Notional | Fair Value | Hypothetical Change in Fair Value |
| | (in millions) | | | | | |
| Equity securities(1) | | $7,560 | $ (756) | | $8,972 | $ (897) |
| Equity-based derivatives(2) | $77,143 | 867 | 1,528 | $52,275 | (128) | 1,373 |
| Variable annuity and other living benefit feature embedded derivatives(2)(3) | | (8,926) | (1,497) | | (8,720) | (1,423) |
| Net estimated potential loss | | | $ (725) | | | $ (947) |

(1) Includes equity securities classified as "Assets supporting experience-rated contractholder liabilities" and "Equity securities, at fair value."

(2) The notional and fair value of equity-based derivatives and the fair value of variable annuity and other living benefit feature embedded derivatives are also reflected in amounts under "Market Risk Related to Interest Rates" above, and are not cumulative.

(3)

Excludes any offsetting impact of derivative instruments purchased to hedge changes in the embedded derivatives. Amounts reported net of third-party reinsurance.

Market Risk Related to Foreign Currency Exchange Rates

As a U.S.-based company with significant business operations outside of the U.S., particularly in Japan, we are exposed to foreign currency exchange rate risk related to these operations, as well as in our general account investment portfolio and other proprietary investment portfolios.

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For our international insurance operations, changes in foreign currency exchange rates create risk that we may experience volatility in the U.S. dollar-equivalent earnings and equity of these operations. We actively manage this risk through various hedging strategies, including the use of foreign currency hedges and through holding U.S. dollar-denominated securities in the investment portfolios of certain of these operations. Additionally, 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 are economically matched to the currency of the product liabilities, the accounting treatment may differ for changes in the value of these assets and liabilities due to moves in foreign currency exchange rates, resulting in volatility in reported U.S. GAAP earnings. This volatility has been mitigated by disaggregating the U.S. and Australian dollar-denominated businesses in Gibraltar Life into separate divisions, each with its own functional currency that aligns with the underlying products and investments. For certain of our international insurance operations outside of Japan, we elect to not hedge the risk of changes in our equity investments due to foreign exchange rate movements. For further information, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Impact of Foreign Currency Exchange Rates—Impact of products denominated in non-local currencies on U.S. GAAP earnings" above.

For our domestic general account investment portfolios supporting our U.S. insurance operations and other proprietary investment portfolios, our foreign currency exchange rate risk arises primarily from investments that are denominated in foreign currencies. We manage this risk by hedging substantially all domestic foreign currency denominated fixed income investments into U.S. dollars. We generally do not hedge all of the foreign currency risk of our investments in equity securities of unaffiliated foreign entities.

We manage our foreign currency exchange rate risks within specified limits, and estimate our exposure, excluding equity in our Japanese insurance operations, to a hypothetical 10% change in foreign currency exchange rates. The following table sets forth the net estimated potential loss in fair value from such a change as of December 31, 2018 and 2017. While these scenarios are for illustrative purposes only and do not reflect our expectations regarding future changes in foreign exchange markets, they represent reasonably possible near-term hypothetical changes that illustrate the potential impact of such events.

| | As of December 31, 2018 | | As of December 31, 2017 | |
|---|---|---|---|---|
| | Fair Value | Hypothetical Change in Fair Value | Fair Value | Hypothetical Change in Fair Value |
| | (in millions) | | | |
| Unhedged portion of equity investment in international subsidiaries and foreign currency denominated investments in domestic general account portfolio | $5,414 | $ 541 | $6,345 | $ (635 ) |

For additional information, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—General Account Investments—Portfolio Composition" and "Management's Discussion and Analysis of Financial Condition and Results of Operations—Results of Operations by Segment—International Insurance Division" above.

Derivatives

We use derivative financial instruments primarily to reduce market risk from changes in interest rates, equity prices and foreign currency exchange rates, including their use to alter interest rate or foreign currency exposures arising from mismatches between assets and liabilities. Our derivatives primarily include swaps, futures, options and forward contracts that are exchange-traded or contracted in the OTC market.

Our derivatives also include interest rate guarantees we provide on our synthetic GIC products. Synthetic GICs simulate the performance of traditional insurance-related GICs but are accounted for as derivatives under U.S. GAAP due to the fact that the policyholders own the underlying assets, and we only provide a book value "wrap" on the customers' funds, which are held in a client-owned trust. Since these wraps provide payment of guaranteed principal and interest to the customer, changes in interest rates create risk such that declines in the market value of customers' funds would increase our net exposure to these guarantees; however, our obligation is limited to payments that are in excess of the existing customers' fund value. Additionally, we have the ability to periodically reset crediting rates, subject to a 0% minimum floor, as well as the ability to increase prices. Further, our contract provisions provide that, although participants may withdraw funds at book value, contractholder withdrawals may only occur at market value immediately, or at book value over time. These factors, among others, result in these contracts experiencing minimal changes in fair value, despite a more significant notional value.

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Our derivatives also include those that are embedded in certain financial instruments, and primarily relate to certain optional living benefit features associated with our variable annuity products, as discussed in more detail in "Market Risk Related to Certain Variable Annuity Products" below. For additional information on our derivative activities, see Note 5 to the Consolidated Financial Statements.

Market Risk Related to Certain Variable Annuity Products

The primary risk exposures of our variable annuity contracts relate to actual deviations from, or changes to, the assumptions used in the original pricing of these products, including capital markets assumptions, such as equity market returns, interest rates and market volatility and actuarial assumptions. For our capital markets assumptions, we manage our exposure to the risk created by capital markets fluctuations through a combination of product design elements, such as an automatic rebalancing element and inclusion of certain optional living benefits in our living benefits hedging program. In addition, we consider external reinsurance a form of risk mitigation as well as our capital hedge program. Certain variable annuity optional living benefit features are accounted for as embedded derivatives and recorded at fair value. The market risk sensitivities associated with U.S. GAAP values of both the embedded derivatives and the related derivatives used to hedge the changes in fair value of these embedded derivatives are provided under "Market Risk Related to Interest Rates" and "Market Risk Related to Equity Prices" above.

For additional information regarding our risk management strategies, including our living benefit hedging program and other product design elements, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Results of Operations by Segment—Individual Annuities" above.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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