
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549**

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2009

OR

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

Commission file number 333-18053

Pruco Life Insurance Company of New Jersey

(Exact name of Registrant as specified in its charter)

New Jersey
(State or other jurisdiction,
incorporation or organization)

22-2426091
(IRS Employer
Identification No.)

213 Washington Street, Newark, New Jersey 07102
(Address of principal executive offices) (Zip Code)

(973) 802-6000
(Registrant's Telephone Number, including area code)

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

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

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

Large accelerated filer	☐	Accelerated filer	☐
Non-accelerated filer	☒	Smaller reporting company	☐

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ☐ NO ☒

As of August 14, 2009, 400,000 shares of the Registrant's Common Stock (par value \$5), were outstanding. As of such date, Pruco Life Insurance Company, an Arizona company and an indirect wholly owned subsidiary of Prudential Financial, Inc., a New Jersey Corporation, owned all of the Registrant's Common Stock.

Pruco Life Insurance Company of New Jersey meets the conditions set forth in General Instruction (H)(1)(a) and (b) on Form 10-Q and is therefore filing this Form with the reduced disclosure format.

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FORWARD-LOOKING STATEMENTS

Certain of the statements included in this Quarterly Report on Form 10-Q, including but not limited to those in Management's Discussion and Analysis of Financial Condition and Results of Operations, constitute forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. Words such as "expects," "believes," "anticipates," "includes," "plans," "assumes," "estimates," "projects," "intends," "should," "will," "shall" or variations of such words are generally part of forward-looking statements. Forward-looking statements are made based on management's current expectations and beliefs concerning future developments and their potential effects upon Pruco Life Insurance Company of New Jersey. There can be no assurance that future developments affecting Pruco Life Insurance Company of New Jersey will be those anticipated by management. These forward-looking statements are not a guarantee of future performance and involve risks and uncertainties, and there are certain important factors that could cause actual results to differ, possibly materially, from expectations or estimates reflected in such forward-looking statements, including, among others: (1) general economic, market and political conditions, including the performance and fluctuations of fixed income, equity, real estate and other financial markets, particularly in light of ongoing severe economic conditions and the severe stress experienced by the global financial markets since the second half of 2007; (2) interest rate fluctuations; (3) re-estimates of our reserves for future policy benefits and claims; (4) differences between actual experience regarding mortality, morbidity, persistency, surrender experience, interest rates, or market returns and the assumptions we use in pricing our products, establishing liabilities and reserves or for other purposes; (5) changes in our assumptions related to deferred policy acquisition costs; (6) changes in our claims-paying ratings; (7) investment losses, defaults and counterparty non-performance; (8) competition in our product lines and for personnel; (9) changes in tax law; (10) fluctuations in foreign currency exchange rates and foreign securities markets; (11) regulatory or legislative changes, including government actions in response to the stress experienced by the global financial markets; (12) adverse determinations in litigation or regulatory matters and our exposure to contingent liabilities; (13) domestic or international military actions, natural or man-made disasters including terrorist activities or pandemic disease, or other events resulting in catastrophic loss of life; (14) ineffectiveness of risk management policies and procedures in identifying, monitoring and managing risks; (15) changes in statutory or U.S. GAAP accounting principles, practices or policies; and (16) changes in assumptions for retirement expense. As noted above, the period since the second half of 2007 has been characterized by extreme adverse market and economic conditions. The foregoing risks are even more pronounced in these unprecedented market and economic conditions. Pruco Life Insurance Company of New Jersey does not intend, and is under no obligation, to update any particular forward-looking statement included in this document. See "Risk Factors" included in this Quarterly Report on Form 10-Q for discussion of certain risks relating to our businesses and investment in our securities.

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

Pruco Life Insurance Company of New Jersey

Unaudited Interim Statements of Financial Position

As of June 30, 2009 and December 31, 2008 (in thousands, except share amounts)

	June 30, 2009	December 31, 2008
ASSETS		
Fixed maturities available for sale, at fair value (amortized cost, 2009: \$976,844; 2008: \$865,995)	\$ 950,767	\$ 796,022
Equity securities available for sale, at fair value (cost, 2009: \$4,143; 2008: \$4,143)	3,279	2,809
Policy loans	169,096	169,924
Short term investments	898	8,137
Commercial mortgage loans	164,378	147,395
Other long term investments	7,294	7,797
Total investments	1,295,712	1,132,084
Cash and cash equivalents	70,771	69,811
Deferred policy acquisition costs	302,721	326,806
Accrued investment income	16,297	15,025
Reinsurance recoverables	296,296	301,336
Receivables from parent and affiliates	37,903	50,377
Deferred sales inducements	25,740	28,014
Other assets	8,801	4,226
Separate account assets	2,525,694	2,306,566
TOTAL ASSETS	<u>\$4,579,935</u>	<u>\$4,234,245</u>
LIABILITIES AND STOCKHOLDER'S EQUITY		
Liabilities		
Policyholders' account balances	982,403	910,344
Future policy benefits and other policyholder liabilities	440,511	458,129
Cash collateral for loaned securities	13,867	16,131
Securities sold under agreements to repurchase	2,849	22,496
Income taxes payable	76,055	66,793
Short term debt to affiliates	—	100
Payable to parent and affiliates	(1,260)	9,822
Other liabilities	90,898	29,546
Separate account liabilities	2,525,694	2,306,566
Total liabilities	<u>\$4,131,017</u>	<u>\$3,819,927</u>
Commitments and Contingent Liabilities (See Note 2)		
Stockholder's Equity		
Common stock, \$5 par value 400,000 shares, authorized; issued and outstanding;	2,000	2,000
Additional Paid-in capital	168,998	168,998
Retained earnings	289,946	273,964
Accumulated other comprehensive loss	(12,026)	(30,644)
Total stockholder's equity	<u>448,918</u>	<u>414,318</u>
TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY	<u>\$4,579,935</u>	<u>\$4,234,245</u>

See Notes to Unaudited Interim Financial Statements

Pruco Life Insurance Company of New Jersey

Unaudited Interim Statements of Operations and Comprehensive Income
Three and Six Months Ended June 30, 2009 and 2008 (in thousands)

	<u>Three months ended June 30,</u>		<u>Six months ended June 30,</u>	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
REVENUES				
Premiums	\$ 3,051	\$ 3,800	\$ 7,636	\$ 7,613
Policy charges and fee income	14,061	17,839	29,651	36,203
Net investment income	17,494	17,308	34,971	34,304
Asset administration fees	1,655	1,804	2,956	3,587
Other income	1,319	1,280	2,304	2,507
Realized investment gains/(losses), net;				
Other-than-temporary impairments on fixed maturity securities	(10,790)	(6,494)	(13,929)	(6,868)
Other-than-temporary impairments on fixed maturity securities transferred to Other Comprehensive Income	8,900	—	10,024	—
Other realized investment gains (losses), net	554	2,719	7,081	(1,662)
Total realized investment gains (losses), net	(1,336)	(3,775)	3,176	(8,530)
Total revenues	<u>36,244</u>	<u>\$ 38,256</u>	<u>\$ 80,694</u>	<u>\$ 75,684</u>
BENEFITS AND EXPENSES				
Policyholders' benefits	3,478	5,820	13,654	10,549
Interest credited to policyholders' account balances	4,184	7,738	21,118	15,000
Amortization of deferred policy acquisition costs	(5,530)	7,130	21,813	17,319
General, administrative and other expenses	3,897	5,482	8,194	10,283
Total benefits and expenses	<u>6,029</u>	<u>26,170</u>	<u>64,779</u>	<u>53,151</u>
Income from operations before income taxes	30,215	12,086	15,915	22,533
Income tax expense	6,598	2,850	3,665	5,762
NET INCOME	<u>23,617</u>	<u>9,236</u>	<u>12,250</u>	<u>16,771</u>
Change in net unrealized investment gains (losses) and changes in foreign currency transaction, net of taxes (1)	14,695	(4,702)	18,617	(8,120)
COMPREHENSIVE INCOME	<u>\$ 38,312</u>	<u>\$ 4,534</u>	<u>\$ 30,867</u>	<u>\$ 8,651</u>

(1) Amounts are net of tax expense of \$8 million and \$3 million tax benefit for the three months ended June 30, 2009 and 2008, respectively, and \$10 million and \$4 million for the six months ended June 30, 2009 and 2008, respectively.

See Notes to Unaudited Interim Financial Statements

Pruco Life Insurance Company of New Jersey

Unaudited Interim Statement of Stockholder's Equity
Six Months Ended June 30, 2009 and 2008 (in thousands)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income Gain (Loss)			Total Stockholder's Equity
				Foreign Currency Translation Adjustments	Net Unrealized Investment Gains (Loss)	Total Accumulated Other Comprehensive Income (Loss)	
Balance, December 31, 2008	\$ 2,000	\$168,998	\$273,964	\$ 26	(\$ 30,670)	(\$ 30,644)	\$ 414,318
Net Income			12,250				12,250
Change in foreign currency translation adjustments, net of taxes				14		14	14
Impact of adoption of FSP FAS 115-2 & 124-2 net of taxes			3,732		(3,732)	(3,732)	—
Change in net unrealized investment gains, net of taxes					22,336	22,336	22,336
Balance, June 30, 2009	\$ 2,000	\$168,998	\$289,946	\$ 40	\$ (12,066)	\$ (12,026)	\$ 448,918
	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)			Total Stockholder's Equity
				Foreign Currency Translation Adjustments	Net Unrealized Investment Gains (Loss)	Total Accumulated Other Comprehensive Income (Loss)	
Balance, December 31, 2007	\$ 2,000	\$168,998	\$252,259	\$ 108	\$ 3,074	\$ 3,182	\$ 426,439
Net income	—	—	16,771		—	—	16,771
Change in foreign currency translation adjustments, net of taxes	—	—	—	61	—	61	61
Change in net unrealized investment (losses), net of taxes	—	—	—	—	(8,181)	(8,181)	(8,181)
Balance, June 30, 2008	\$ 2,000	\$168,998	\$269,030	\$ 169	(\$ 5,107)	(\$ 4,938)	\$ 435,090

See Notes to Unaudited Interim Financial Statements

Pruco Life Insurance Company of New Jersey

Unaudited Interim Statements of Cash Flows

Six Months Ended June 30, 2009 and 2008 (in thousands)

	Six months ended, June 30	
	2009	2008
CASH FLOWS (USED IN) FROM OPERATING ACTIVITIES:		
Net income	\$ 12,250	\$ 16,771
Adjustments to reconcile net income to net cash (used in) from operating activities:		
Policy charges and fee income	(12,755)	(11,434)
Interest credited to policyholders' account balances	21,118	15,000
Realized investment (gains) losses, net	(3,176)	8,531
Amortization and other non-cash items	(412)	(328)
Change in:		
Future policy benefits and other insurance liabilities	(4,598)	63,952
Reinsurance recoverable	5,040	(66,417)
Accrued investment income	(1,272)	576
Receivable from parent and affiliates	9,920	(2,221)
Payable to parent and affiliates	(11,082)	(561)
Deferred policy acquisition costs	(2,258)	(8,654)
Income taxes payable	(2,772)	(2,249)
Deferred sales inducements	2,274	(3,076)
Other, net	(15,793)	(7,905)
Cash Flows (Used In) From Operating Activities	(3,516)	1,985
CASH FLOWS (USED IN) INVESTING ACTIVITIES:		
Proceeds from the sale/maturity/prepayment of:		
Fixed maturities, available for sale	81,233	172,073
Policy loans	10,757	8,882
Commercial mortgage loans	1,774	1,364
Equity securities, available for sale	—	—
Payments for the purchase of:		
Fixed maturities, available for sale	(132,332)	(106,409)
Policy loans	(6,371)	(7,364)
Commercial mortgage loans	(19,324)	(42,302)
Equity securities, available for sale	—	—
Notes receivable from parent and affiliates, net	(1,351)	(700)
Other long-term investments, net	400	(2,027)
Short-term investments, net	7,239	(1,932)
Cash Flows (Used In) Investing Activities	(57,975)	21,585
CASH FLOWS FROM FINANCING ACTIVITIES:		
Policyholders' account deposits	212,210	132,994
Policyholders' account withdrawals	(130,872)	(115,622)
Net change in securities sold under agreement to repurchase and cash collateral for loaned securities	(21,911)	(3,908)
Net change in financing arrangements (maturities 90 days or less)	3,024	(53,310)
Cash Flows From Financing Activities	62,451	(39,846)
Net increase (decrease) in cash and cash equivalents	960	(16,276)
Cash and cash equivalents, beginning of year	69,811	33,185
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 70,771	\$ 16,909
SUPPLEMENTAL CASH FLOW INFORMATION		
Income taxes paid	\$ 6,437	\$ 8,011
Interest paid	\$ 6	\$ 486

See Notes to Unaudited Interim Financial Statements

1. BASIS OF PRESENTATION

Pruco Life Insurance Company of New Jersey, or the “Company,” is a wholly owned subsidiary of the Pruco Life Insurance Company, or “Pruco Life,” which in turn is a wholly owned subsidiary of The Prudential Insurance Company of America, or “Prudential Insurance.” Prudential Insurance is an indirect wholly owned subsidiary of Prudential Financial, Inc., or “Prudential Financial.”

The unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States, or “U.S. GAAP,” on a basis consistent with reporting interim financial information in accordance with instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission (“SEC”). The Company has evaluated subsequent events through August 14, 2009, the date these financial statements were issued as part of this Quarterly Report on Form 10-Q. These interim financial statements are unaudited but reflect all adjustments that, in the opinion of management, are necessary to provide a fair statement of the consolidated results of operations and financial condition of the Company for the interim periods presented. All such adjustments are of a normal recurring nature. The results of operations for any interim period are not necessarily indicative of results for a full year.

The Company has extensive transactions and relationships with Prudential Insurance and other affiliates. Due to these relationships, it is possible that the terms of these transactions are not the same as those that would result from transactions among wholly unrelated parties. These unaudited financial statements should be read in conjunction with the financial statements and notes thereto contained in the Company’s Annual Report on Form 10-K for the year ended December 31, 2008.

Use of Estimates

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

The most significant estimates include those used in determining deferred policy acquisition costs and related amortization; valuation of investments including derivatives and the recognition of other-than-temporary impairments; future policy benefits including guarantees; provision for income taxes and valuation of deferred tax assets; and reserves for contingent liabilities, including reserves for losses in connection with unresolved legal matters.

Reclassifications

Certain amounts in prior periods have been reclassified to conform to the current period presentation. The Unaudited Interim Statements of Cash Flows for 2008 have been revised to reflect cash activities related to certain policyholders’ account deposits and withdrawals as gross and net according to the Company’s policy.

2. CONTINGENT LIABILITIES AND LITIGATION AND REGULATORY MATTERS

Contingencies

On an ongoing basis, our internal supervisory and control functions review the quality of our sales, marketing, administration and servicing, and other customer interface procedures and practices and may recommend modifications or enhancements. From time to time, this review process results in the discovery of administration, servicing or other errors, including errors relating to the timing or amount of payments or contract values due to customers. In certain cases, if appropriate, we may offer customers appropriate remediation and may incur charges and expenses, including the costs of such remediation, administrative costs and regulatory fines.

It is possible that the results of operations or the cash flow of the Company in a particular quarterly or annual period could be materially affected as a result of payments in connection with the matters discussed above depending, in part, upon the results of operations or cash flow for such period. Management believes, however, that the ultimate payments in connection with these matters should not have a material adverse effect on the Company’s financial position.

Litigation and Regulatory Matters

The Company is subject to legal and regulatory actions in the ordinary course of its businesses, including class action lawsuits. Legal and regulatory actions may include proceedings relating to aspects of the businesses and operations that are specific to the Company and that are typical of the businesses in which the Company operates. Class action and individual lawsuits may involve a variety of issues and/or allegations, which include sales practices, underwriting practices, claims payment and procedures, premium charges, and, policy servicing. The Company may also be subject to litigation arising out of its general business activities, such as investments and third party contracts. In certain of these matters, plaintiffs may seek large and/or indeterminate amounts, including punitive or exemplary damages.

Commencing in 2003, Prudential Financial received formal requests for information from the SEC and the New York Attorney General’s Office (“NYAG”) relating to market timing in variable annuities by certain American Skandia entities. In connection with these investigations, with the approval of Skandia, an offer was made by American Skandia to the SEC and NYAG, to settle these matters by paying restitution and a civil penalty of \$95 million in the aggregate. In April 2009, AST Investment Services, Inc., formerly named American Skandia Investment Services, Inc. (“ASISI”), reached a resolution of the previously disclosed investigations by the SEC and the NYAG into market timing related misconduct involving certain variable annuities. The settlements relate to conduct that generally occurred between January 1998 and September 2003. ASISI is an affiliate of the Company and serves as investment manager for certain investment options under the Company’s variable life insurance and annuity products. Prudential Financial acquired ASISI from Skandia Insurance Company Ltd. (publ) (“Skandia”) in May 2003. Subsequent to the acquisition, Prudential Financial implemented controls, procedures and measures designed to protect customers from the types of activities involved in these investigations. These settlements resolve the investigations by the above named authorities into these matters, subject to the settlement terms. Under the terms of the settlements, ASISI has paid a total of \$34 million in disgorgement and an additional \$34 million as a civil money penalty. These amounts will be paid into a Fair Fund administered by the SEC to compensate those harmed by the market timing related activities. In the settlements, ASISI has agreed to retain, at its ongoing cost and expense, the services of an Independent Distribution consultant acceptable to the Staff of the SEC to develop a proposed plan for the distribution of Fair Fund amounts according to a methodology developed in consultation with and acceptable to the Staff. As part of these settlements, ASISI has undertaken that by the end of 2009 it will undergo a compliance review by an independent third party, who shall issue a report of its findings and recommendations to ASISI’s Board of Directors, the Audit Committee of the Advanced Series Trust Board of Trustees and the Staff of the SEC. In addition, ASISI has agreed, among other things, to continue to cooperate with the SEC and NYAG in any litigation, ongoing investigations or other proceedings relating to or arising from their investigations into these matters. Under the terms of the purchase agreement pursuant to which Prudential Financial acquired ASISI from Skandia, Prudential Financial was indemnified for the costs of the settlements.

2. CONTINGENT LIABILITIES AND LITIGATION AND REGULATORY MATTERS (continued)

The Company's litigation and regulatory matters are subject to many uncertainties, and given their complexity and scope, their outcomes cannot be predicted. It is possible that results of operations or cash flow of the Company in a particular quarterly or annual period could be materially affected by an ultimate unfavorable resolution of pending litigation and regulatory matters depending, in part, upon the results of operations or cash flow for such period. In light of the unpredictability of the Company's litigation and regulatory matters, it is also possible that in certain cases an ultimate unfavorable resolution of one or more pending litigation or regulatory matters could have a material adverse effect on the Company's financial position. Management believes, however, that, based on information currently known to it, the ultimate outcome of all pending litigation and regulatory matters, after consideration of applicable reserves and rights to indemnification, is not likely to have a material adverse effect on the Company's financial position.

3. ACCOUNTING POLICIES AND ACCOUNTING PRONOUNCEMENTS

Investments in Debt and Equity Securities

Fixed maturities are comprised of bonds, notes and redeemable preferred stock. Fixed maturities classified as "available for sale" are carried at fair value. See Note 6 for additional information regarding the determination of fair value. The amortized cost of fixed maturities is adjusted for amortization of premiums and accretion of discounts to maturity. Interest income, as well as the related amortization of premium and accretion of discount is included in "Net investment income" under the effective yield method. For mortgage-backed and asset-backed securities, the effective yield is based on estimated cash flows, including prepayment assumptions based on data from widely accepted third-party data sources or internal estimates. In addition to prepayment assumptions, cash flow estimates vary based on assumptions regarding the underlying collateral including default rates and changes in value. These assumptions can significantly impact income recognition and the amount of other-than-temporary impairments recognized in other comprehensive income. For high credit quality mortgage-backed and asset-backed securities (those rated AA or above), cash flows are provided quarterly, and the amortized cost and effective yield of the security are adjusted as necessary to reflect historical prepayment experience and changes in estimated future prepayments. The adjustments to amortized cost are recorded as a charge or credit to net investment income in accordance with the retrospective method. For asset-backed and mortgage-backed securities rated below AA, the effective yield is adjusted prospectively for any changes in estimated cash flows. See the discussion below on realized investment gains and losses for a description of the accounting for impairments as well as the impact of the Company's adoption of FASB Staff Position ("FSP") FAS 115-2 and FAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments." Unrealized gains and losses on fixed maturities classified as "available for sale," net of tax, and the effect on deferred policy acquisition costs and future policy benefits that would result from the realization of unrealized gains and losses, are included in "Accumulated other comprehensive income (loss)."

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

Short-term investments primarily consist of investments in certain money market funds as well as highly liquid debt instruments with a maturity of greater than three months and less than twelve months when purchased. These investments are generally carried at fair value.

Realized investment gains (losses) are computed using the specific identification method. Realized investment gains and losses are generated from numerous sources, including the sale of fixed maturity securities, equity securities, investments in joint ventures and limited partnerships and other types of investments, as well as adjustments to the cost basis of investments for other than temporary impairments.

The Company's available-for-sale securities with unrealized losses are reviewed quarterly to identify other-than-temporary impairments in value. In evaluating whether a decline in value is other-than-temporary, the Company considers several factors including, but not limited to the following: (1) the extent and the duration of the decline; (2) the reasons for the decline in value (credit event, currency or interest-rate related, including general credit spread widening); and (3) the financial condition of and near-term prospects of the issuer. With regard to available-for-sale equity securities, the Company also considers the ability and intent to hold the investment for a period of time to allow for a recovery of value. When it is determined that a decline in value of an equity security is other-than-temporary, the carrying value of the equity security is reduced to its fair value, with a corresponding charge to earnings.

3. ACCOUNTING POLICIES AND ACCOUNTING PRONOUNCEMENTS (continued)

In addition, in April 2009, the Financial Accounting Standards Board ("FASB") issued FSP FAS 115-2 and FAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments." The Company early adopted this guidance on January 1, 2009. This guidance indicates that an other-than-temporary impairment must be recognized in earnings for a debt security in an unrealized loss position when an entity either (a) has the intent to sell the debt security or (b) more likely than not will be required to sell the debt security before its anticipated recovery. Prior to the adoption of this guidance the Company was required to record an other-than-temporary impairment for a debt security unless it could assert that it had both the intent and ability to hold the security for a period of time sufficient to allow for a recovery in its fair value to its amortized cost basis. For all debt securities in unrealized loss positions that do not meet either of these two criteria, FSP FAS 115-2 and FAS 124-2 requires that the Company analyze its ability to recover the amortized cost by comparing the net present value of projected future cash flows with the amortized cost of the security. The net present value is calculated by discounting the Company's best estimate of projected future cash flows at the effective interest rate implicit in the debt security prior to impairment. The Company may use the estimated fair value of collateral as a proxy for the net present value if it believes that the security is dependent on the liquidation of collateral for recovery of its investment. If the net present value is less than the amortized cost of the investment, an other-than-temporary impairment is recorded.

Under FSP FAS 115-2 and FAS 124-2, when an other-than-temporary impairment of a debt security has occurred, the amount of the other-than-temporary impairment recognized in earnings depends on whether the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis. If the debt security meets either of these two criteria, the other-than-temporary impairment recognized in earnings is equal to the entire difference between the security's amortized cost basis and its fair value at the impairment measurement date. For other-than-temporary impairments of debt securities that do not meet these two criteria, the net amount recognized in earnings is equal to the difference between the amortized cost of the debt security and its net present value calculated as described above. Any difference between the fair value and the net present value of the debt security at the impairment measurement date is recorded in "Other comprehensive income (loss)." Unrealized gains or losses on securities for which an other-than-temporary impairment has been recognized in earnings is tracked as a separate component of "Accumulated other comprehensive income (loss)." Prior to the adoption of FSP FAS 115-2 and FAS 124-2, an other-than-temporary impairment recognized in earnings for debt securities was equal to the total difference between amortized cost and fair value at the time of impairment.

For debt securities, the split between the amount of an other-than-temporary impairment recognized in other comprehensive income and the net amount recognized in earnings is driven principally by assumptions regarding the amount and timing of projected cash flows. For mortgage-backed and asset-backed securities, cash flow estimates including prepayment assumptions, are based on data from widely accepted third-party data sources or internal estimates. In addition to prepayment assumptions, cash flow estimates vary based on assumptions regarding the underlying collateral including default rates, recoveries and changes in value. For all other debt securities, cash flow estimates are driven by assumptions regarding probability of default and estimates regarding timing and amount of recoveries associated with a default.

The Company has developed these estimates using information based on its historical experience as well as using market observable data, such as industry analyst reports and forecasts, sector credit ratings and other data relevant to the collectability of a security.

The new cost basis of an impaired security is not adjusted for subsequent increases in estimated fair value. In periods subsequent to the recognition of an other-than-temporary impairment, the impaired security is accounted for as if it had been purchased on the measurement date of the impairment. For debt securities, the discount (or reduced premium) based on the new cost basis may be accreted into net investment income in future periods based on prospective changes in cash flow estimates, to reflect adjustments to the effective yield.

Derivative Financial Instruments

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

Derivatives are used to manage the characteristics of the Company's asset/liability mix, manage the interest rate and currency characteristics of assets or liabilities. Additionally, derivatives may be used to seek to reduce exposure to interest rate and foreign currency risks associated with assets held or expected to be purchased or sold, and liabilities incurred or expected to be incurred.

3. ACCOUNTING POLICIES AND ACCOUNTING PRONOUNCEMENTS (continued)

Derivatives are recorded as assets, within “Other long-term investments,” in the Statement of Financial Position, except for embedded derivatives, which are recorded in the Statement of Financial Position with the associated host contract. The Company nets the fair value of all derivative financial instruments with counterparties for which a master netting arrangement has been executed pursuant to Financial Accounting Standards Board (“FASB”) Interpretation (“FIN”) No. 39 and FASB Staff Position (“FSP”) No. 39-1. As discussed in detail below and in Note 8, all realized and unrealized changes in fair value of derivatives, with the exception of the effective portion of cash flow hedges, are recorded in current earnings. Cash flows from these derivatives are reported in the operating activities section in the Statements of Cash Flows.

The Company designates derivatives as either (1) a hedge of the fair value of a recognized asset or liability or unrecognized firm commitment (“fair value” hedge), (2) a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability (“cash flow” hedge), (3) a foreign currency fair value or cash flow hedge (“foreign currency” hedge), (4) a hedge of a net investment in a foreign operation, or (5) a derivative entered into as an economic hedge that does not qualify for hedge accounting. If a derivative does not qualify for hedge accounting, all changes in its fair value, including net receipts and payments, are included in “Realized investment (losses), net” without considering changes in the fair value of the economically associated assets or liabilities.

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

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

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

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

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

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

3. ACCOUNTING POLICIES AND ACCOUNTING PRONOUNCEMENTS (continued)

The Company is a party to financial instruments that contain derivative instruments that are “embedded” in the financial instruments. At inception, the Company assesses whether the economic characteristics of the embedded derivative are clearly and closely related to the economic characteristics of the remaining component of the financial instrument (i.e., the host contract) and whether a separate instrument with the same terms as the embedded instrument would meet the definition of a derivative instrument. When it is determined that (1) the embedded derivative possesses economic characteristics that are not clearly and closely related to the economic characteristics of the host contract, and (2) a separate instrument with the same terms would qualify as a derivative instrument, the embedded derivative is separated from the host contract, carried at fair value, and changes in its fair value are included in “Realized investment gains (losses), net.” For certain financial instruments that contain an embedded derivative that otherwise would need to be bifurcated and reported at fair value, the Company may elect to classify the entire instrument as a trading account asset and report it within “Other trading account assets,” at fair value. The Company has entered into reinsurance agreements to transfer the risk related to the embedded derivatives to affiliates. These reinsurance agreements are derivatives and have been accounted in the same manner as the embedded derivative.

Income Taxes

The Company’s liability for income taxes includes the liability for unrecognized tax benefits and interest and penalties which relate to tax years still subject to review by the Internal Revenue Service (“IRS”) or other taxing jurisdictions. Audit periods remain open for review until the statute of limitations has passed. Generally, for tax years which produce net operating losses, capital losses or tax credit carryforwards (“tax attributes”), the statute of limitations does not close, to the extent of these tax attributes, until the expiration of the statute of limitations for the tax year in which they are fully utilized. The completion of review or the expiration of the statute of limitations for a given audit period could result in an adjustment to the liability for income taxes. The statute of limitations for the 2002 tax year expired on April 30, 2009. The statute of limitations for the 2003 tax year expired on July 31, 2009. The statute of limitations for the 2004 and 2005 tax years is set to expire in June 2010. Tax years 2006 through 2008 are still open for IRS examination. The Company does not anticipate any significant changes within the next 12 months to its total unrecognized tax benefits related to tax years for which the statute of limitations has not expired.

As discussed above, the completion of review or the expiration of the statute of limitations for a given audit period could result in an adjustment to the liability for income taxes. As such, the second quarter of 2009 benefited from a reduction to the liability for unrecognized tax benefits and interest of \$1 million related to tax years prior to 2002 as a result of the expiration of the statute of limitations for the 2002 tax year. Also as discussed above, the statute of limitations for the 2003 tax year expired on July 31, 2009. As a result, the Company’s income tax provision for the third quarter of 2009 will include a reduction to the liability for unrecognized tax benefits and interest of approximately \$1.7 million related to tax years prior to 2002.

The dividends received deduction (“DRD”) reduces the amount of dividend income subject to U.S. tax and is a significant component of the difference between the Company’s effective tax rate and the federal statutory tax rate of 35%. The DRD for the current period was estimated using information from 2008, current year results, and was adjusted to take into account the current year’s equity market performance. The actual current year DRD can vary from the estimate based on factors such as, but not limited to, changes in the amount of dividends received that are eligible for the DRD, changes in the amount of distributions received from mutual fund investments, changes in the account balances of variable life and annuity contracts, and the Company’s taxable income before the DRD.

In August 2007, the IRS released Revenue Ruling 2007-54, which included, among other items, guidance on the methodology to be followed in calculating the DRD related to variable life insurance and annuity contracts. In September 2007, the IRS released Revenue Ruling 2007-61. Revenue Ruling 2007-61 suspends Revenue Ruling 2007-54 and informs taxpayers that the U.S. Treasury Department and the IRS have indicated that they intend to address through new regulations the issues considered in Revenue Ruling 2007-54, including the methodology to be followed in determining the DRD related to variable life insurance and annuity contracts. On May 11, 2009, the Obama Administration released the “General Explanations of the Administration’s Revenue Proposals.” Although the Administration has not released proposed statutory language, one proposal would change the method used to determine the amount of the DRD. A change in the DRD, including the possible retroactive or prospective elimination of this deduction through regulation or legislation, could increase actual tax expense and reduce the Company’s consolidated net income. These activities had no impact on the Company’s 2008 or 2009 results.

In December 2006, the IRS completed all fieldwork with respect to its examination of the consolidated federal income tax returns for tax years 2002 and 2003. The final report was initially submitted to the Joint Committee on Taxation for their review in April 2007. The final report was resubmitted in March 2008 and again in April 2008. The Joint Committee returned the report to the IRS for additional review of an industry issue regarding the methodology for calculating the DRD related to variable life insurance and annuity contracts. The IRS completed its review of the issue and proposed an adjustment with respect to the calculation of the DRD. In order to expedite receipt of an income tax refund related to the 2002 and 2003 tax years,

3. ACCOUNTING POLICIES AND ACCOUNTING PRONOUNCEMENTS (continued)

the Company has agreed to such adjustment. The report, with the adjustment to the DRD, was submitted to the Joint Committee on Taxation in October 2008. The Company was advised on January 2, 2009 that the Joint Committee completed its consideration of the report and has taken no exception to the conclusions reached by the IRS. Accordingly, the final report was processed and a refund was received in February 2009. The Company believes that its return position with respect to the calculation of the DRD is technically correct. Therefore, the Company intends to file a protective refund claim within six months of the expiration of the respective statutes of limitations to recover the taxes associated with the agreed upon adjustment and to pursue such other actions as appropriate. These activities had no impact on the Company's 2008 or 2009 results.

In January 2007, the IRS began an examination of tax years 2004 through 2006. For tax years 2007, 2008 and 2009, the Company participated in the IRS's Compliance Assurance Program ("CAP"). Under CAP, the IRS assigns an examination team to review completed transactions contemporaneously during these tax years in order to reach agreement with the Company on how they should be reported in the tax returns. If disagreements arise, accelerated resolutions programs are available to resolve the disagreements in a timely manner before the tax returns are filed. It is management's expectation this program will shorten the time period between the filing of the Company's federal income tax returns and the IRS's completion of its examination of the returns.

Accounting Pronouncements Adopted

In May 2009, the FASB issued SFAS No. 165, "Subsequent Events." This statement addresses the accounting for and disclosure of subsequent events not addressed in other applicable GAAP, including disclosure of the date through which subsequent events have been evaluated. This guidance is effective for interim or annual periods ending after June 15, 2009. The Company's adoption of this guidance effective with the interim period ending June 30, 2009 did not have a material effect on the Company's consolidated financial position or results of operations. The required disclosure of the date through which subsequent events have been evaluated is provided in Note 1.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, "Interim Disclosures about Fair Value of Financial Instruments." This FSP requires disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This FSP also amends the disclosure requirements. This FSP is effective for interim reporting periods ending after June 15, 2009, with early adoption permitted. The Company has adopted this guidance beginning with the interim period ending June 30, 2009. The Required disclosures are provided in Note 6.

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments." This FSP amends the other-than-temporary impairment guidance for debt securities and expands the presentation and disclosure requirements of other-than-temporary impairments on debt and equity securities in the financial statements. This FSP also requires that the required annual disclosures be made for interim reporting periods. This FSP does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. This FSP is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Company adopted this guidance on January 1, 2009, which resulted in a net after-tax increase to retained earnings and decrease to Accumulated other comprehensive income (loss) of \$3.7 million, as of January 1, 2009. The disclosures required by this FSP are provided in Note 7.

In April 2009, the FASB issued FSP FAS 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly." This FSP amends FASB Statement No. 157, "Fair Value Measurements", to provide guidance on (1) estimating the fair value of an asset or liability if there was a significant decrease in the volume and level of trading activity for these assets or liabilities, and (2) identifying transactions that are not orderly. Further, FSP 157-4 requires additional disclosures about fair value measurements in interim and annual periods and supersedes FSP FAS 157-3, "Determining the Fair Value of a Financial Asset in a Market That Is Not Active". This FSP is effective for interim and annual reporting periods ending after June 15, 2009, and shall be applied prospectively. Early adoption is permitted for periods ending after March 15, 2009. The Company's early adoption of this guidance effective January 1, 2009 did not have a material effect on the Company's consolidated financial position or results of operations. The disclosures required by this FSP are provided in Note 6.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities" an amendment of SFAS No. 133. This statement amends and expands the disclosure requirements for derivative instruments and hedging activities by requiring companies to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under FASB Statement No. 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. The Company's adoption of this guidance effective January 1, 2009 did not have a material effect on the Company's financial position or results of operations. The required disclosures are provided in Note 8.

3. ACCOUNTING POLICIES AND ACCOUNTING PRONOUNCEMENTS (continued)

In February 2008, the FASB issued FSP FAS 140-3, "Accounting for Transfers of Financial Assets and Repurchase Financing Transactions." The FSP provides recognition and derecognition guidance for a repurchase financing transaction, which is a repurchase agreement that relates to a previously transferred financial asset between the same counterparties, that is entered into contemporaneously with or in contemplation of, the initial transfer. The FSP is effective for fiscal years beginning after November 15, 2008. The Company's adoption of this guidance on a prospective basis effective January 1, 2009 did not have a material effect on the Company's financial position or results of operations.

In February 2008, the FASB issued FSP FAS 157-2, "Effective Date of FASB Statement No. 157." This FSP applies to nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). FSP FAS 157-2 delays the effective date of SFAS No. 157 for these items to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The Company's adoption of this guidance effective January 1, 2009 did not have a material effect on the Company's financial position or results of operations.

Recent Accounting Pronouncements

In June 2009, the FASB issued SFAS No. 168, "The FASB Accounting Standards Codification TM and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162." The FASB's Codification was launched on July 1, 2009 as the source of authoritative U.S. GAAP to be applied by nongovernmental entities. The Codification is not intended to change U.S. GAAP but is a new structure which takes accounting pronouncements and organizes them by accounting topic. This statement is effective for financial statements issued for interim and annual periods ending after September 15, 2009. This statement will become effective for the Company beginning with the interim reporting period ending September 30, 2009 and will impact the way the Company references U.S. GAAP accounting standards in the financial statements.

In June 2009, the FASB issued SFAS No. 167, "Amendments to FASB Interpretation No. 46(R)." This statement amends the consolidation guidance for variable interest entities. It also makes certain changes to the disclosures required under FSP FAS 140-4 and FIN 46(R)-8, "Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities," which the Company adopted effective December 31, 2008. This statement is effective for interim and annual reporting periods beginning after November 15, 2009. The Company will adopt this guidance effective January 1, 2010. The Company is currently assessing the impact of this statement on the Company's financial position, results of operations and financial statement disclosures.

In June 2009, the FASB issued SFAS No. 166, "Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140." This statement changes the accounting for transfers of financial assets, and is effective for transfers of financial assets occurring in interim and annual reporting periods beginning after November 15, 2009. It removes the concept of a qualifying special-purpose entity (QSPE) from Statement No. 140 and removes the exception from applying FASB Interpretation No. 46, "Consolidation of Variable Interest Entities," to qualifying special-purpose entities. It also defines "participating interest" to establish specific conditions for reporting a transfer of a portion of a financial asset as a sale. Disclosure provisions will be applied to transfers that occurred both before and after January 1, 2010. The Company will adopt this guidance effective January 1, 2010. The Company is currently assessing the impact of this statement on the Company's financial position, results of operations and financial statement disclosures.

4. REINSURANCE

The Company participates in reinsurance with Prudential Insurance, Prudential Arizona Reinsurance Captive Company “PARCC”, Pruco Life, and Pruco Reinsurance, Ltd. “Pruco Re”, in order to provide risk diversification, additional capacity for future growth and limit the maximum net loss potential arising from large risks. Life reinsurance is accomplished through various plans of reinsurance, primarily yearly renewable term and coinsurance. Reinsurance ceded arrangements do not discharge the Company as the primary insurer. Ceded balances would represent a liability of the Company in the event the reinsurers were unable to meet their obligations to the Company under the terms of the reinsurance agreements. The likelihood of a material reinsurance liability resulting from such inability of reinsurers to meet their obligation is considered to be remote.

Reinsurance premiums, commissions, expense reimbursements, benefits and reserves related to reinsured long-duration contracts are accounted for over the life of the underlying reinsured contracts using assumptions consistent with those used to account for the underlying contracts. Amounts recoverable from reinsurers for both long and short-duration contracts are estimated in a manner consistent with the claim liabilities and policy benefits associated with the reinsured policies. The affiliated reinsurance agreements are described further in Note 5 of the Unaudited Interim Financial Statements.

Reinsurance amounts included in the Company’s Unaudited Interim Statement of Operations and Comprehensive Income for the three and six months ended June 30, 2009 and 2008 are presented below.

	(in thousands)			
	Three months		Six months	
	2009	2008	2009	2008
Gross premiums and policy charges and fee income	\$ 63,015	\$ 61,532	\$129,190	\$124,209
Reinsurance ceded	(45,903)	(39,893)	(91,903)	(80,393)
Net premiums and policy charges and fee income	\$ 17,112	\$ 21,639	\$ 37,287	\$ 43,816
Policyholders’ benefits ceded	\$ 20,187	\$ 38,531	\$ 41,423	\$ 53,706
Realized capital (losses)/gains net, associated with SFAS No. 133	<u>\$ (14,436)</u>	<u>\$ (2,603)</u>	<u>\$ (37,250)</u>	<u>\$ 2,577</u>

Reinsurance premiums ceded for interest-sensitive life products is accounted for as a reduction of policy charges and fee income. Reinsurance ceded for term insurance products is accounted for as a reduction of premiums.

Realized investment gains and losses include the reinsurance of the Company’s derivatives under SFAS No. 133. Changes in the fair value of the embedded derivatives are recognized through “Realized investment gains(losses) net”. The Company has entered into reinsurance agreements to transfer the risk related to certain living benefit options on variable annuities to Pruco Re. These reinsurance agreements are derivatives and have been accounted for in the same manner as an embedded derivative.

Reinsurance recoverables included in the Company’s Unaudited interim Statements of Financial Position, at June 30, 2009 and December 31, 2008 were \$296 million and \$301 million, respectively.

The gross and net amounts of life insurance in-force as of June 30, 2009 and 2008 were as follows:

	(in thousands)	
	2009	2008
Gross life insurance in-force	\$ 92,656,297	\$ 84,438,997
Reinsurance Ceded	(84,208,478)	(75,017,125)
Net life insurance in-force	<u>\$ 8,447,819</u>	<u>\$ 9,421,872</u>

5. RELATED PARTY TRANSACTIONS

The Company has extensive transactions and relationships with Prudential Insurance and other affiliates. Although we seek to ensure that these transactions and relationships are fair and reasonable, it is possible that the terms of these transactions are not the same as those that would result from transactions among wholly unrelated parties.

Expense Charges and Allocations

Many of the Company's expenses are allocations or charges from Prudential Insurance or other affiliates. These expenses can be grouped into general and administrative expenses and agency distribution expenses.

The Company's general and administrative expenses are charged to the Company using allocation methodologies based on business processes. Management believes that the methodology is reasonable and reflects costs incurred by Prudential Insurance to process transactions on behalf of the Company. The Company operates under service and lease agreements whereby services of officers and employees, supplies, use of equipment and office space are provided by Prudential Insurance. The Company reviews its allocation methodology periodically which it may adjust accordingly. General and administrative expenses include allocations of stock compensation expenses related to a stock option program and a deferred compensation program issued by Prudential Financial. The expense charged to the Company for the stock option program was less than \$1 million for the three months and the six months ended June 30, 2009 and 2008, respectively. The expense charged to the Company for the deferred compensation program was less than \$1 million for the three months and the six months ended June 30, 2009 and 2008, respectively.

The Company receives a charge to cover its share of employee benefits expenses. These expenses include costs for funded and non-funded contributory and non-contributory defined benefit pension plans. Some of these benefits are based on final group earning and length of service. While others are based on an account balance, which takes into consideration age, service and earnings during career.

Prudential Insurance sponsors voluntary savings plans for the Company's employee's 401(k) plans. The plans provide for salary reduction contributions by employees and matching contributions by the Company of up to 4% of annual salary. The expense charged to the Company for the matching contribution to the plans was less than \$1 million for the three and the six months ended June 30, 2009 and 2008.

The Company's share of net expense for the pension plans was less than \$1 million for the three months and the six months ended June 30, 2009 and 2008.

The Company is charged distribution expenses from Prudential Insurance's agency network for both its domestic life and annuity products through a transfer pricing agreement, which is intended to reflect a market based pricing arrangement.

Affiliated Asset Administration Fee Income

Effective April 15, 2009, the Company amended an agreement with AST Investment Services, Inc., formerly known as American Skandia Investment Services, Inc, whereas the Company receives fee income calculated on contractholder separate account balances invested in the Advanced Series Trust, formerly known as American Skandia Trust. Income received from AST Investment Services, Inc. related to this agreement was \$0.2 million for the three and six months ended June 30, 2009. These revenues are recorded as "Asset administration fees" in the unaudited interim Statements of Operations and Comprehensive Income.

Beginning October 1, 2002, in accordance with a servicing agreement with Prudential Investments LLC, the Company receives fee income from policyholder account balances invested in the Prudential Series Funds ("PSF"). The Company also receives fee income calculated on contractholder separate account balances invested in the Advanced Series Trust Funds. These revenues are recorded as "Asset administration fees" in the Unaudited Interim Statements of Operations and Comprehensive Income.

Corporate Owned Life Insurance

The Company has sold two Corporate Owned Life Insurance, or "COLI", policies to Prudential Insurance and one to Prudential Financial. The cash surrender value included in separate accounts for these COLI contracts was \$664 million and \$564 million at June 30, 2009 and December 31, 2008, respectively. Fees related to these COLI policies in the three months ended June 30, 2009 and 2008 were \$3 million and \$2 million, respectively; and \$6 million and \$4 million for the six months ended June 30, 2009 and 2008, respectively.

Reinsurance with Affiliates

Pruco Life

Effective April 1, 2008, The Company entered into an agreement to reinsure certain variable COLI policies with Pruco Life. Reinsurance recoverables related to this agreement were less than \$1 million as of June 30, 2009 and \$2 million as of December 31, 2008, respectively. Fees ceded to Pruco Life were \$1 million for the three months ended June 30, 2009 and 2008 and \$3 million and \$1 million for the six months ended June 30, 2009 and 2008,

5. RELATED PARTY TRANSACTIONS (continued)

respectively. Benefits ceded decreased for the three months ended June 30, 2009 as compared to June 30, 2008 from \$1 million to zero. The benefits ceded decreased from \$1 million for the six months ended June 30, 2008 to \$.3 million for the six months ended June 30, 2009, respectively. The Company is not relieved of its primary obligation to the policyholder as a result of this agreement.

PARCC

The Company reinsures 90% of the risks under its term life insurance policies through an automatic coinsurance agreement with PARCC. Reinsurance recoverables related to this agreement were \$269 million and \$239 million as of June 30, 2009 and December 31, 2008, respectively. Premiums ceded to PARCC for the three months ended June 30, 2009 and 2008 were \$35 million and \$31 million, respectively; and \$70 million and \$62 million for the six months ended June 30, 2009 and 2008, respectively. Benefits ceded for the three months ended June 31, 2009 and 2008 were \$11 million and \$25 million, respectively; and \$24 million and \$34 million for the six months ended June 30, 2009 and 2008, respectively. Reinsurance expense allowances, net of capitalization and amortization for the three months ended June 30, 2009 and June 31, 2008 were \$8 million and \$6 million; and \$16 million and \$12 million for the six months ended June 30, 2009 and 2008, respectively. The Company is not relieved of its primary obligation to the policyholder as a result of this agreement.

Prudential Insurance

The Company has a yearly renewable term reinsurance agreement with Prudential Insurance and reinsures the majority of all mortality risks not otherwise reinsured. The reinsurance recoverables related to this agreement were \$9 million and \$5 million as of June 30, 2009 and December 31, 2008, respectively. Premiums and fees ceded to Prudential Insurance for the three months ended June 30, 2009 and 2008 were \$10 million and \$8 million, respectively; and \$19 million and \$17 million for the six months ended June 30, 2009 and 2008, respectively. Benefits ceded for the three months ended June 30, 2009 and 2008 were \$9 million and \$12 million, respectively; and \$17 million and \$18 million for the six months ended June 30, 2009 and 2008, respectively. The Company is not relieved of its primary obligation to the policyholder as a result of this agreement.

Pruco Re

The Company reinsures 100% of the risk on its Lifetime 5 ("LT5"), and Spousal Lifetime Five benefit ("SLT5") feature sold on certain of its annuities through an automatic coinsurance agreement with Pruco Re. Fees ceded on this agreement, for the three months ended June 30, 2009 and June 30, 2008 were \$.3 million and \$.4 million, respectively; and \$1 million and \$1 million for the six months ended June 30, 2009 and June 30, 2008, respectively.

Debt Agreements

The Company and its parent, Pruco Life, have an agreement with Prudential Funding, LLC, a wholly owned subsidiary of Prudential Insurance, which allows it to borrow funds for working capital and liquidity needs. The borrowings under this agreement are limited to \$100 million. The Company had no debt outstanding to Prudential Funding, LLC as of June 30, 2009 compared to \$3 million outstanding at June 30, 2008. Interest expense related to his agreement was less than \$1 million as of June 30, 2009 and 2008. The related interest was charged at a variable rate ranging from 3.05% to 7.05% for 2009 and 2.11% to 4.31% for 2008.

Derivative Trades

In its ordinary course of business, the Company enters into over-the-counter (OTC) derivative contracts with an affiliate, Prudential Global Funding, LLC. For these OTC derivative contracts, Prudential Global Funding, LLC has a substantially equal and offsetting position with an external counterparty.

6. FAIR VALUE OF ASSETS AND LIABILITIES

Fair Value Measurement – Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS No. 157 establishes a framework for measuring fair value that includes a hierarchy used to classify the inputs used in measuring fair value. The hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three levels. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement. The levels of the fair value hierarchy are as follows:

Level 1 – Fair value is based on unadjusted quoted prices in active markets that are accessible to the Company for identical assets or liabilities. These generally provide the most reliable evidence and are used to measure fair value whenever available. Active markets are defined as having the following for the measured asset/liability: i) many transactions, ii) current prices, iii) price quotes not varying substantially among market makers, iv) narrow bid/ask spreads and v) most information publicly available. The Company's Level 1 assets and liabilities primarily include certain cash equivalents and short term investments, equity securities and derivative contracts that are traded in an active exchange market. Prices are obtained from readily available sources for market transactions involving identical assets or liabilities.

Level 2 – Fair value is based on significant inputs, other than Level 1 inputs, that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability through corroboration with observable market data. Level 2 inputs include quoted market prices in active markets for similar assets and liabilities, quoted market prices in markets that are not active for identical or similar assets or liabilities and other observable inputs. The Company's Level 2 assets and liabilities include: fixed maturities (corporate public and private bonds, most government securities, certain asset-backed and mortgage-backed securities, etc.), certain equity securities, short-term investments and cash equivalents (primarily commercial paper), and certain over-the-counter derivatives. Valuations are generally obtained from third party pricing services for identical or comparable assets or liabilities through the use of valuation methodologies using observable market inputs.

Prices from pricing services are sourced from multiple vendors, and a vendor hierarchy is maintained by asset type based on historical pricing experience and vendor expertise. The Company generally receives prices from multiple pricing services for each security, but ultimately uses the price from the pricing service highest in the vendor hierarchy based on the respective asset type. In order to validate reasonability, prices are reviewed by internal asset managers through comparison with directly observed recent market trades and internal estimates of current fair value, developed using market observable inputs and economic indicators.

The fair value of private fixed maturities are primarily determined using a discounted cash flow model. In certain cases these models primarily use observable inputs with a discount rate based upon the average of spread surveys collected from private market intermediaries who are active in both primary and secondary transactions, taking into account, among other factors, the credit quality and industry sector of the issuer and the reduced liquidity associated with private placements. Private fixed maturities also include debt investments in funds that, in addition to a stated coupon, pay a return based upon the results of the underlying portfolios. The fair values of these securities are determined by reference to the funds' net asset value (NAV). Any restrictions on the ability to redeem interests in these funds at NAV are considered to have a de minimis effect on the fair value.

The majority of the Company's derivative positions is traded in the OTC derivative market and is classified within Level 2 in the fair value hierarchy. OTC derivatives classified within Level 2 are valued using models generally accepted in the financial services industry that use actively quoted or observable market input values from external market data providers, non-binding broker-dealer quotations, third-party pricing vendors and/or recent trading activity. The fair values of most OTC derivatives, including interest rate swaps, cross currency swaps and single name credit default swaps are determined using discounted cash flow models. These models' key assumptions include the contractual terms of the respective contract, along with significant observable inputs, including interest rates, currency rates, credit spreads, yield curves, index dividend yields and nonperformance risk and volatility. Substantially all of the Company's OTC derivative contracts are transacted with an affiliate. In instances where the Company transacts with unaffiliated counterparties derivative agreements are with highly rated major international financial institutions. Consistent with the practice of major international financial institutions, the Company uses the credit spread embedded in the London Interbank Offered Rate ("LIBOR") interest rate curve to reflect nonperformance risk when determining the fair value of derivative assets and liabilities. The Company believes this credit spread is an appropriate estimate of the nonperformance risk for derivative related assets and liabilities between highly rated institutions after consideration of the impacts of the collateral posting process. Most OTC derivative contracts have bid and ask prices that are actively quoted or can be readily obtained from external market data providers. The Company's policy is to use mid-market pricing in determining its best estimate of fair value.

6. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

Level 3 – Fair value is based on at least one or more significant unobservable inputs for the asset or liability. These inputs reflect the Company's assumptions about the assumptions market participants would use in pricing the asset or liability. The Company's Level 3 assets and liabilities primarily include: certain private fixed maturities and equity securities, certain manually priced public equity securities and fixed maturities, certain highly structured over-the-counter derivative contracts, certain commercial mortgage loans, certain consolidated real estate funds for which the Company is the general partner, and embedded derivatives resulting from certain products with guaranteed benefits. In circumstances where vendor pricing is not available, internally developed valuations or non-binding broker quotes are used to determine fair value. Non-binding broker quotes are reviewed for reasonableness, based on the Company's understanding of the market. These estimates may use significant unobservable inputs, which reflect the Company's own assumptions about the inputs market participants would use in pricing the asset. Circumstances where observable market data are not available may include events such as market illiquidity and credit events related to the security. Under certain conditions, based on its observations of transactions in active markets, the Company may conclude the prices received from independent third party pricing services or brokers are not reasonable or reflective of market activity. In those instances, the Company may choose to over-ride the third-party pricing information or quotes received and apply internally developed values to the related assets or liabilities. In such cases, the valuations are generally classified as Level 3. As of June 30, 2009 and December 31, 2008 over-rides on a net basis were not material.

For certain private fixed maturities, the discounted cash flow model may also incorporate significant unobservable inputs, which reflect the Company's own assumptions about the inputs market participants would use in pricing the asset. Certain public fixed maturities and private fixed maturities priced internally are based on observable and unobservable inputs. Significant unobservable inputs used include: issue specific credit adjustments, material non-public financial information, management judgment, estimation of future earnings and cash flows, default rate assumptions, liquidity assumptions and non-binding quotes from market makers. These inputs are usually considered unobservable, as not all market participants will have access to this data.

Estimated fair values for most privately traded equity securities are determined using valuation and discounted cash flow models that require a substantial level of judgment. In determining the fair value of certain privately traded equity securities the discounted cash flow model may also use unobservable inputs, which reflect the Company's assumptions about the inputs market participants would use in pricing the asset.

The fair values of the GMAB and GMIWB liabilities are calculated as the present value of future expected benefit payments to customers less the present value of assessed rider fees attributable to the embedded derivative feature. Since there is no observable active market for the transfer of these obligations, the valuations are calculated using internally developed models with option pricing techniques. The models are based on a risk neutral valuation framework and incorporate premiums for risks inherent in valuation techniques, inputs, and the general uncertainty around the timing and amount of future cash flows. The determination of these risk premiums requires the use of management judgment. Under SFAS No. 157, the Company is also required to incorporate the Company's own risk of non-performance in the valuation of the embedded derivatives associated with the Company's optional living benefit features. Since insurance liabilities are senior to debt, the Company believes that reflecting the claims-paying ratings of the Company's insurance subsidiaries in the valuation of the liability appropriately takes into consideration the Company's own risk of non-performance. Historically, the expected cash flows were discounted using forward LIBOR interest rates, which were commonly viewed as being consistent with AA quality claims-paying ratings. However, in light of first quarter of 2009 developments, including rating agency downgrades to the claims-paying ratings of the Company's insurance subsidiaries, the Company determined that forward LIBOR interest rates were no longer indicative of the Company's claims-paying ability. As a result, beginning in the first quarter of 2009, to reflect the market's perception of its non-performance risk, the Company incorporated an additional spread over LIBOR into the discount rate used in the valuations of the embedded derivatives associated with our optional living benefit features, thereby increasing the discount rate and reducing the fair value of the embedded derivative liabilities. The additional spread over LIBOR is determined taking into consideration publicly available information relating to the claims-paying ability of the Company's insurance subsidiaries, as indicated by the credit spreads associated with funding agreements issued by these subsidiaries. The Company adjusts these credit spreads to remove any liquidity risk premium. The additional spread over LIBOR incorporated into the discount rate as of June 30, 2009 generally ranged from 100 to 200 basis points for the portion of the interest rate curve most relevant to these liabilities.

Other significant inputs to the valuation models for the embedded derivatives associated with the optional living benefit features of the Company's variable annuity products include capital market assumptions, such as interest rate and implied volatility assumptions, as well as various policyholder behavior assumptions that are actuarially determined, including lapse rates, benefit utilization rates, mortality rates and withdrawal rates. These assumptions are reviewed at least annually, and updated based upon historical experience and give consideration to any observable market data, including market transactions such as acquisitions and reinsurance transactions. In the first quarter of 2009 the Company updated the volatility assumptions for the its annuities business to reflect both the implied volatility of over-the-counter equity options and an index based on historical volatilities.

6. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

Level 3 includes OTC derivatives where the bid-ask spreads are generally wider than derivatives classified within Level 2 thus requiring more judgment in estimating the mid-market price of such derivatives.

Derivatives that are valued based upon models with unobservable market input values or input values from less actively traded or less-developed markets are classified within Level 3 in the fair value hierarchy. Derivatives classified as Level 3 include first-to-default credit basket swaps. The fair values of first-to-default credit basket swaps are derived from relevant observable inputs such as: individual credit default spreads, interest rates, recovery rates and unobservable model-specific input values such as correlation between different credits within the same basket. Level 3 methodologies are validated through periodic comparison of the Company's fair values to broker-dealer's values.

The table below presents the balances of assets and liabilities measured at fair value on a recurring basis, as of June 30, 2009.

	Level 1	Level 2 (in thousands)	Level 3	Total
Fixed maturities, available for sale:				
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$ —	\$ 127,699	\$ —	\$ 127,699
Foreign government bonds	—	11,374	—	11,374
Corporate securities	—	538,931	1,048	539,979
Asset-backed securities	—	61,993	6,175	68,168
Commercial mortgage-backed securities	—	91,788	—	91,788
Residential mortgage-backed securities	—	111,759	—	111,759
Sub-total	—	943,544	7,223	950,767
Equity securities, available for sale	—	2,736	543	3,279
Other long-term investments	—	(224)	(1,415)	(1,639)
Short term investments	898	—	—	898
Cash and cash equivalents	3,000	67,770	—	70,770
Other assets	—	3,250	21,842	25,092
Sub-total excluding separate account assets	3,898	1,017,076	28,193	1,049,167
Separate account assets (1)	1,342,350	1,177,820	5,525	2,525,695
Total assets	<u>\$ 1,346,248</u>	<u>\$ 2,194,896</u>	<u>\$ 33,718</u>	<u>\$ 3,574,862</u>
Future policy benefits	—	—	14,200	14,200
Total liabilities	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 14,200</u>	<u>\$ 14,200</u>

- (1) Separate account assets represent segregated funds that are invested for certain customers. Investment risks associated with market value changes are borne by the customers, except to the extent of minimum guarantees made by the Company with respect to certain accounts. Separate account liabilities are not included in the above table as they are reported at contract value and not fair value in the Company's Statement of Financial Position.

6. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

The table below presents the balances of assets and liabilities measured at fair value on a recurring basis, as of December 31, 2008.

	Level 1	Level 2 (in thousands)	Level 3	Total
Fixed maturities, available for sale	\$ —	790,024	5,998	796,022
Equity securities, available for sale	—	2,688	121	2,809
Other long-term investments	—	3,069	(4,272)	(1,203)
Short-term investments	137	8,000	—	8,137
Cash and cash equivalents	—	70,631	—	70,631
Other assets	—	3,226	58,880	62,106
Sub-total excluding separate account assets	137	877,638	60,727	938,502
Separate account assets (1)	1,142,614	1,157,458	6,494	2,306,566
Total assets	\$ 1,142,751	2,035,096	67,221	3,245,068
Future policy benefits	—	—	63,903	63,903
Total liabilities	\$ —	—	63,903	63,903

- (1) Separate account assets represent segregated funds that are invested for certain customers. Investment risks associated with market value changes are borne by the customers, except to the extent of minimum guarantees made by the Company with respect to certain accounts. Separate account liabilities are not included in the above table as they are reported at contract value and not fair value in the Company's Statement of Financial Position.

6. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

The following tables provide a summary of the changes in fair value of Level 3 assets and liabilities for the three and six months ended June 30, 2009 as well as the portion of gains or losses included in income for the three and six months ended June 30, 2009 attributable to unrealized gains or losses related to those assets and liabilities still held at June 30, 2009.

	Three Months Ended June 30, 2009				
	Fixed Maturities, Available For Sale – Corporate Securities	Fixed Maturities, Available For Sale – Asset- Backed Securities	Equity Securities, Available for Sale (in thousands)	Other Long-term Investments	Other Assets
Fair value, beginning of period	\$ 286	\$ 5,755	\$ 555	\$ (4,726)	\$ 36,530
Total gains or (losses) (realized/unrealized):					
Included in earnings:					
Realized investment gains (losses), net:					
Other-than-temporary impairments on fixed maturity securities	(21)	—	—	—	—
Other-than-temporary impairments on fixed maturity Securities transferred to Other Comprehensive Income	20	—	—	—	—
Other realized investment gains (losses), net	—	(2)	—	—	—
Total realized investment gains (losses), net	(1)	(2)	—	3,311	(14,443)
Asset management fees and other income	—	—	—	—	—
Included in other comprehensive income (loss)	21	532	(12)	—	31
Net investment income	—	18	—	—	—
Purchases, sales, issuances, and settlements	30	(128)	—	—	(276)
Foreign currency translation	—	—	—	—	—
Transfers into (out of) Level 3 (2)	712	—	—	—	—
Fair value, end of period	\$ 1,047	\$ 6,173	\$ 543	\$ (1,415)	\$ 21,842
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held by the Company at the end of the period					
Included in earnings:					
Realized investment gains (losses), net:					
Other-than-temporary impairments on fixed maturity securities	(21)	—	—	—	—
Other-than-temporary impairments on fixed maturity Securities transferred to Other Comprehensive Income	20	—	—	—	—
Other realized investment gains (losses), net	—	—	—	—	—
Total realized investment gains (losses), net	\$ (1)	\$ —	\$ —	\$ 3,311	\$(14,380)
Asset management fees and other income	\$ —	\$ —	\$ —	\$ —	\$ —
Interest credited to policyholder account	\$ —	\$ —	\$ —	\$ —	\$ —
Included in other comprehensive income (loss)	\$ —	\$ 532	\$ (12)	\$ —	\$ 31

6. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

	Separate Account Assets ⁽¹⁾	Future Policy Benefits
	(in thousands)	
Fair value, beginning of period	\$ 5,762	\$(33,788)
Total gains or (losses) (realized/unrealized):		
Included in earnings:		
Realized investment gains (losses), net	—	20,125
Interest credited to policyholder account	(260)	—
Included in other comprehensive income	—	—
Net investment income	—	—
Purchases, sales, issuances, and settlements	23	(537)
Transfers into (out of) Level 3 (2)	—	—
Fair value, end of period	<u>\$ 5,525</u>	<u>\$(14,200)</u>
Unrealized gains(losses) for the period relating to those level 3 assets and liabilities that were still held by the Company at the end of the period:		
Included in earnings:		
Realized investment gains (losses), net	\$ —	\$ 18,746
Interest credited to policyholder account	\$ (260)	\$ —
Included in other comprehensive income	\$ —	\$ —

- (1) Separate account assets represent segregated funds that are invested for certain customers. Investment risks associated with market value changes are borne by the customers, except to the extent of minimum guarantees made by the Company with respect to certain accounts. Separate account liabilities are not included in the above table as they are reported at contract value and not fair value in the Company's Statement of Financial Position.
- (2) Transfers into or out of Level 3 are generally reported as the value of the beginning of the quarter in which the transfer occurs.

Transfers – Net transfers into Level 3 for Fixed Maturities Available for Sale totaled \$1 million during the three months ended June 30, 2009. Transfers into Level 3 for these investments were primarily the result of unobservable inputs utilized within valuation methodologies and the use of broker quotes when information from third party pricing services was utilized. Partially offsetting these transfers into Level 3 were transfers out of Level 3 due to the use of observable inputs in valuation methodologies as well as the utilization of pricing service information for certain assets that the Company was able to validate.

6. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

	Six Months Ended June 30, 2009				
	Fixed Maturities, Available For Sale – Corporate Securities	Fixed Maturities, Available For Sale – Asset- Backed Securities	Equity Securities, Available for Sale (in thousands)	Other Long-term Investments	Other Assets
Fair value, beginning of period	\$ 266	\$ 5,732	\$ 121	\$ (4,272)	\$ 58,880
Total gains or (losses) (realized/unrealized):					
Included in earnings:					
Realized investment gains (losses), net:					
Other-than-temporary impairments on fixed maturity securities	(21)	—	—	—	—
Other-than-temporary impairments on fixed maturity					
Securities transferred to Other Comprehensive Income	20	—	—	—	—
Other realized investment gains (losses), net	—	(2)	—	—	—
Total realized investment gains (losses), net	(1)	(2)	—	2,858	(37,260)
Asset management fees and other income	—	—	—	—	—
Included in other comprehensive income (loss)	96	674	422	—	107
Net investment income	(1)	18	—	—	—
Purchases, sales, issuances, and settlements	29	(247)	—	—	115
Foreign currency translation	—	—	—	—	—
Transfers into (out of) Level 3 (2)	658	—	—	—	—
Fair value, end of period	\$ 1,047	\$ 6,173	\$ 543	\$ (1,415)	\$ 21,842
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held by the Company at the end of the period					
Included in earnings:					
Realized investment gains (losses), net:					
Other-than-temporary impairments on fixed maturity securities	(21)	—	—	—	—
Other-than-temporary impairments on fixed maturity					
Securities transferred to Other Comprehensive Income	20	—	—	—	—
Other realized investment gains (losses), net	—	—	—	—	—
Total realized investment gains (losses), net	\$ (1)	\$ —	\$ —	\$ 2,858	\$(36,966)
Asset management fees and other income	\$ —	\$ —	\$ —	\$ —	\$ —
Interest credited to policyholder account	\$ —	\$ —	\$ —	\$ —	\$ —
Included in other comprehensive income (loss)	\$ 96	\$ 674	\$ 422	\$ —	\$ (463)

6. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

	Separate Account Assets ⁽¹⁾	Future Policy Benefits
	(in thousands)	
Fair value, beginning of period	\$ 6,494	\$(63,903)
Total gains or (losses) (realized/unrealized):		
Included in earnings:		
Realized investment gains (losses), net	—	50,518
Interest credited to policyholder account	(1,007)	—
Included in other comprehensive income	—	—
Net investment income	—	—
Purchases, sales, issuances, and settlements	38	(815)
Transfers into (out of) Level 3 (2)	—	—
Fair value, end of period	<u>\$ 5,525</u>	<u>\$(14,200)</u>
Unrealized gains(losses) for the period relating to those level 3 assets and liabilities that were still held by the Company at the end of the period:		
Included in earnings:		
Realized investment gains (losses), net	\$ —	\$ 49,937
Interest credited to policyholder account	\$ (260)	\$ —
Included in other comprehensive income	\$ —	\$ —

- (1) Separate account assets represent segregated funds that are invested for certain customers. Investment risks associated with market value changes are borne by the customers, except to the extent of minimum guarantees made by the Company with respect to certain accounts. Separate account liabilities are not included in the above table as they are reported at contract value and not fair value in the Company's Statement of Financial Position.

- (2) Transfers into or out of Level 3 are generally reported as the value of the beginning of the quarter in which the transfer occurs.

Transfers – Net transfers into Level 3 for Fixed Maturities Available for Sale totaled \$1 million during the six months ended June 30, 2009. Transfers into Level 3 for these investments were primarily the result of unobservable inputs utilized within valuation methodologies and the use of broker quotes when information from third party pricing services was utilized. Partially offsetting these transfers into Level 3 were transfers out of Level 3 due to the use of observable inputs in valuation methodologies as well as the utilization of pricing service information for certain assets that the Company was able to validate.

6. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

The following tables provide a summary of the changes in fair value of Level 3 assets and liabilities for the three and six months ending June 30, 2008, as well as the portion of gains or losses included in income for the three and six months ended June 30, 2008, attributable to unrealized gains or losses related to those assets and liabilities still held at June 30, 2008.

	Three Months Ending June 30, 2008			
	Fixed Maturities, Available For Sale	Equity Securities, Available for Sale (in thousands)	Other Long-term Investments	Other Assets
Fair value, beginning of period	\$ 18,772	\$ 2,175	\$ (1,219)	\$ 8,637
Total gains or (losses) (realized/unrealized):	—	—	—	—
Included in earnings:	—	—	—	—
Realized investment gains (losses), net	(15)	—	168	(2,556)
Interest credited to policyholder account	—	—	—	—
Included in other comprehensive income (loss)	15	—	—	—
Net investment income	—	—	—	—
Purchases, sales, issuances, and settlements	2,891	—	—	344
Foreign currency translation	—	—	—	—
Transfers into (out of) Level 3 (2)	(17,320)	(1,728)	—	—
Fair value, end of period	<u>\$ 4,343</u>	<u>\$ 447</u>	<u>\$ (1,051)</u>	<u>\$ 6,425</u>

Unrealized gains (losses) for the period relating to those level 3 assets that were still held by the Company at the end of the period:

Included in earnings:				
Realized investment gains (losses), net	\$ (15)	\$ —	\$ 169	\$(2,490)
Interest credited to policyholder account	\$ —	\$ —	\$ —	\$ —
Included in other comprehensive income (loss)	\$ —	\$ —	\$ —	\$ —

	Separate Account Assets ⁽¹⁾ (in thousands)	Future Policy Benefits
Fair value, beginning of period	\$ 7,732	\$(8,770)
Total gains or (losses) (realized/unrealized):	—	—
Included in earnings:	—	—
Realized investment gains (losses), net	—	2,629
Interest credited to policyholder account	55	—
Included in other comprehensive income	—	—
Net investment income	—	—
Purchases, sales, issuances, and settlements	—	(367)
Transfers into (out of) Level 3 (2)	—	—
Fair value, beginning of period	<u>\$ 7,787</u>	<u>\$(6,508)</u>

Unrealized gains(losses) for the period relating to those level 3 assets and liabilities that were still held by the Company at the end of the period:

Included in earnings:		
Realized investment gains (losses), net	\$ —	\$ 2,554
Interest credited to policyholder account	\$ 55	\$ —
Included in other comprehensive income	\$ —	\$ —

6. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

- (1) Separate account assets represent segregated funds that are invested for certain customers. Investment risks associated with market value changes are borne by the customers, except to the extent of minimum guarantees made by the Company with respect to certain accounts. Separate account liabilities are not included in the above table as they are reported at contract value and not fair value in the Company's Statement of Financial Position.
- (2) Transfers into or out of Level 3 are generally reported as the value of the beginning of the quarter in which the transfer occurs.

Transfers – Net transfers out of Level 3 for Fixed Maturities Available for Sale totaled \$17 million during the three months ended June 30, 2008. Transfers into Level 3 for these investments were primarily the result of unobservable inputs utilized within valuation methodologies and the use of broker quotes when information from third party pricing services was utilized. Partially offsetting these transfers into Level 3 were transfers out of Level 3 due to the use of observable inputs in valuation methodologies as well as the utilization of pricing service information for certain assets that the Company was able to validate.

The following tables provide a summary of the changes in fair value of Level 3 assets and liabilities for the three and six months ending June 30, 2008, as well as the portion of gains or losses included in income for the three and six months ended June 30, 2008, attributable to unrealized gains or losses related to those assets and liabilities still held at June 30, 2008.

	Six Months Ending June 30, 2008			
	Fixed Maturities, Available For Sale	Equity Securities, Available for Sale	Other Long-term Investments	Other Assets
	(in thousands)			
Fair value, beginning of period	\$ 23,659	\$ 2,271	\$ (279)	\$3,079
Total gains or (losses) (realized/unrealized):	—	—	—	—
Included in earnings:	—	—	—	—
Realized investment gains (losses), net	(24)	—	(772)	2,689
Interest credited to policyholder account	—	—	—	—
Included in other comprehensive income (loss)	(1,511)	(96)	—	—
Net investment income	9	—	—	—
Purchases, sales, issuances, and settlements	(2,033)	—	—	657
Foreign currency translation	—	—	—	—
Transfers into (out of) Level 3 (2)	(15,757)	(1,728)	—	—
Fair value, end of period	\$ 4,343	\$ 447	\$ (1,051)	\$6,425
Unrealized gains (losses) for period relating to those level 3 assets that were still held by the Company at the end of the period:				
Included in earnings:				
Realized investment gains (losses), net	\$ —	\$ —	\$ (771)	\$2,784
Interest credited to policyholder account	\$ —	\$ —	\$ —	\$ —
Included in other comprehensive income (loss)	\$ (101)	\$ —	\$ —	\$ —

6. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

	Separate Account Assets ⁽¹⁾	Future Policy Benefits
	(in thousands)	
Fair value, beginning of period	\$ 7,716	\$(3,087)
Total gains or (losses) (realized/unrealized):	—	—
Included in earnings:	—	—
Realized investment gains (losses), net	—	(2,728)
Interest credited to policyholder account	71	—
Included in other comprehensive income	—	—
Net investment income	—	—
Purchases, sales, issuances, and settlements	—	(693)
Transfers into (out of) Level 3 (2)	—	—
Fair value, end of period	<u>\$ 7,787</u>	<u>\$(6,508)</u>
Unrealized gains (losses) for period relating to those level 3 assets and liabilities that were still held by the Company at the end of the period:		
Included in earnings:		
Realized investment gains (losses), net	\$ —	\$(2,831)
Interest credited to policyholder account	\$ 71	\$ —
Included in other comprehensive income	\$ —	\$ —

- (1) Separate account assets represent segregated funds that are invested for certain customers. Investment risks associated with market value changes are borne by the customers, except to the extent of minimum guarantees made by the Company with respect to certain accounts. Separate account liabilities are not included in the above table as they are reported at contract value and not fair value in the Company's Statement of Financial Position.
- (2) Transfers into or out of Level 3 are generally reported as the value of the beginning of the quarter in which the transfer occurs.

Transfers – Net transfers out of Level 3 for Fixed Maturities Available for Sale totaled \$16 million during the six months ended June 30, 2008. Transfers into Level 3 for these investments were primarily the result of unobservable inputs utilized within valuation methodologies and the use of broker quotes when information from third party pricing services was utilized. Partially offsetting these transfers into Level 3 were transfers out of Level 3 due to the use of observable inputs in valuation methodologies as well as the utilization of pricing service information for certain assets that the Company was able to validate.

Fair Value of Financial Instruments – Under SFAS No. 107, "Disclosures about Fair Value of Financial Instruments," the Company is required to disclose the fair value of certain financial instruments. For the following financial instruments the carrying amount equals or approximates fair value: fixed maturities classified as available for sale, trading account assets, equity securities, securities purchased under agreements to resell, short-term investments, cash and cash equivalents, accrued investment income, separate account assets, securities sold under agreements to repurchase, and cash collateral for loaned securities, as well as certain items recorded within other assets and other liabilities such as broker-dealer related receivables and payables. See Note 8 for a discussion of derivative instruments.

Commercial mortgage loans

The fair value of commercial mortgage loans are primarily based upon the present value of the expected future cash flows discounted at the appropriate U.S. Treasury rate adjusted for the current market spread for similar quality loans.

Policy loans

The fair value of policy loans is calculated using a discounted cash flow model based upon current U.S. Treasury rates and historical loan repayment patterns.

6. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

Investment Contracts – Policyholders’ Account Balances

Only the portion of policyholders’ account balances and separate account liabilities related to products that are investment contracts (those without significant mortality or morbidity risk) are reflected in the table below. For fixed deferred annuities, payout annuities and other similar contracts without life contingencies, fair value is derived using discounted projected cash flows based on interest rates that are representative of the Company’s claims paying ratings, and hence reflects the Company’s own nonperformance risk. For those balances that can be withdrawn by the customer at any time without prior notice or penalty, the fair value is the amount estimated to be payable to the customer as of the reporting date, which is generally the carrying value.

The following table discloses the Company’s financial instruments where the carrying amounts and fair values may differ:

	June 30, 2009	
	Carrying Amount	Fair Value
	(in thousands)	
Assets:		
Commercial mortgage loans	\$ 164,378	\$ 156,456
Policy loans	169,096	197,336
Liabilities:		
Policyholder account balances – Investment contracts	79,382	77,630

7. INVESTMENTS

Fixed Maturities and Equity Securities

The following tables provide information relating to fixed maturities and equity securities (excluding investments classified as trading) as of the dates indicated:

	June 30, 2009				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (in thousands)	Fair Value	Other-than- temporary impairments in AOCI (3)
Fixed maturities, available for sale					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$126,833	\$ 1,088	\$ 222	\$127,699	\$ —
Obligations of U.S. states and their political subdivisions	—	—	—	—	—
Foreign government bonds	10,473	905	—	11,378	—
Corporate securities	551,543	8,744	20,309	539,978	(708)
Asset-backed securities(1)	83,482	1,192	16,507	68,167	(13,715)
Commercial mortgage-backed securities	97,774	333	6,320	91,787	—
Residential mortgage-backed securities (2)	106,739	5,619	600	111,758	(738)
Total fixed maturities, available for sale	\$976,844	\$ 17,881	\$ 43,958	\$950,767	\$ (15,161)
Equity securities, available for sale	\$ 4,143	\$ 95	\$ 959	\$ 3,279	\$ —

(1) Includes credit tranch securities collateralized by sub-prime mortgages, auto loans, credit cards, education loans, and other asset types.

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

(3) Represents the amount of other-than-temporary impairment losses in "Accumulated other comprehensive income (loss)," or "AOCI," which, from January 1, 2009, were not included in earnings under FSP FAS 115-2 and FAS 124-2. Amount excludes \$.9 million of unrealized gains (losses) on impaired securities relating to changes in the fair value of such securities subsequent to the impairment measurement date.

	December 31, 2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (in thousands)	Fair Value
Fixed maturities, available for sale				
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$ 30,556	\$ 3,721	\$ —	\$ 34,277
Foreign government bonds	9,391	573	7	9,957
Corporate securities	498,380	3,203	49,346	452,237
Asset-backed securities	103,724	1,582	18,827	86,479
Commercial mortgage-backed securities	104,156	157	15,110	89,203
Residential mortgage-backed securities	119,788	5,064	983	123,869
Total fixed maturities, available for sale	\$ 865,995	\$ 14,300	\$ 84,273	\$ 796,022
Equity securities, available for sale	\$ 4,143	\$ —	\$ 1,334	\$ 2,809

7. INVESTMENTS (continued)

The amortized cost and fair value of fixed maturities by contractual maturities at June 30, 2009, is as follows:

	Available for Sale	
	Amortized Cost	Fair Value
	(in thousands)	
Due in one year or less	\$ 124,348	\$124,942
Due after one year through five years	279,885	281,111
Due after five years through ten years	197,880	191,660
Due after ten years	86,736	81,339
Asset-backed securities	83,482	68,168
Commercial mortgage-backed securities	97,774	91,788
Residential mortgage-backed securities	106,739	111,759
Total	\$ 976,844	\$950,767

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

Other Long term Investments

The following table provides information relating to other long term investments as of:

	June 30, 2009	December 31, 2008
	(in thousands)	
Company's investment in Separate accounts	\$ 2,185	\$ 2,829
Joint ventures and limited partnerships	6,748	6,171
Derivatives	(1,639)	(1,203)
Total other long- term investments	\$ 7,294	\$ 7,797

The following table depicts the sources of fixed maturity proceeds and related gross investment gains (losses), as well as losses on impairments of both fixed maturities and equity securities:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(in thousands)			
Fixed maturities, available for sale:				
Proceeds from sales	\$ 8,918	\$76,212	\$ 14,036	\$90,497
Proceeds from maturities/repayments	\$ 35,856	\$35,098	\$ 67,255	\$81,376
Gross investment gains from sales, prepayments and maturities	\$ 44	\$ 705	\$ 99	\$ 705
Gross investment losses from sales and maturities	\$ (2,763)	\$ (2,440)	\$ (2,800)	\$ (2,440)
Fixed maturity and equity security impairments:				
Total writedowns for other-than-temporary impairment losses on fixed maturities	\$(10,790)	\$(6,494)	\$(13,929)	\$(6,868)
Portion of loss recognized in other comprehensive income (before taxes)	<u>8,900</u>	<u>—</u>	<u>10,024</u>	<u>—</u>
Net writedowns for other-than-temporary impairment losses on fixed maturities recognized in earnings	\$ (1,890)	\$ (6,494)	\$ (3,905)	\$ (6,868)
Write downs for other-than-temporary impairment losses on equity securities	—	—	—	—

7. INVESTMENTS (continued)

As discussed in Note 3, a portion of certain other-than-temporary impairment (“OTTI”) losses on fixed maturity securities are recognized in “Other comprehensive income (loss)” (“OCI”). The net amount recognized in earnings (“credit loss impairments”) represents the difference between the amortized cost of the 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. Any remaining difference between the fair value and amortized cost is recognized in OCI. The following tables set forth the amount of pre-tax credit loss impairments on fixed maturity securities held by the Company as of the dates indicated, for which a portion of the OTTI loss was recognized in OCI, and the corresponding changes in such amounts for the periods indicated.

Credit losses recognized in earnings on fixed maturity securities held by the Company for which a portion of the OTTI loss was recognized in OCI	(in thousands)
Balance, December 31, 2008	\$ —
Credit losses remaining in retained earnings related to adoption of FSP FAS115-2 and FAS124-2	2,361
Credit loss impairments previously recognized on securities which matured, paid down, prepaid or were sold during the period	(107)
Credit loss impairments previously recognized on securities impaired to fair value during the period (1)	—
Credit loss impairment recognized in the current period on securities not previously impaired	2,473
Additional credit loss impairments recognized in the current period on securities previously impaired	976
Increases due to passage of time on previously recorded credit losses	121
Accretion of credit loss impairments previously recognized due to an increase in cash flows expected to be collected	38
Balance, June 30, 2009	\$ 5,862

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

Credit losses recognized in earnings on fixed maturity securities held by the Company for which a portion of the OTTI loss was recognized in OCI	(in thousands)
Balance, March 31, 2009	\$ 2,399
Credit losses remaining in retained earnings related to adoption of FSP FAS115-2 and FAS124-2	—
Credit loss impairments previously recognized on securities which matured, paid down, prepaid or were sold during the period	(107)
Credit loss impairments previously recognized on securities impaired to fair value during the period (1)	—
Credit loss impairment recognized in the current period on securities not previously impaired	2,473
Additional credit loss impairments recognized in the current period on securities previously impaired	976
Increases due to passage of time on previously recorded credit losses	121
Accretion of credit loss impairments previously recognized due to an increase in cash flows expected to be collected	—
Balance, June 30, 2009	\$ 5,862

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

7. INVESTMENTS (continued)

Net Investment Income

Net investment income for the three months and six months ended June 30, 2009 and 2008 was from the following sources:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(in thousands)			
Fixed maturities, available for sale	\$13,418	\$13,237	\$26,679	\$26,434
Equity securities, available for sale	52	61	119	134
Commercial mortgage and other loans	2,320	1,985	4,509	3,778
Policy loans	2,302	2,287	4,551	4,553
Short-term investments and cash equivalents	100	315	359	778
Other long-term investments	(57)	194	47	320
Gross investment income	18,135	18,079	36,264	35,997
Less investment expenses	(641)	(771)	(1,293)	(1,693)
Net investment income	<u>\$17,494</u>	<u>\$17,308</u>	<u>\$34,971</u>	<u>\$34,304</u>

Realized Investment Gains (Losses), Net

Realized investment gains (losses), net, for the three months ended June 30, 2009 and 2008 were from the following sources:

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
	(in thousands)			
Other-than-temporary impairment losses on fixed maturities, net	\$(10,790)	\$(6,494)	\$(13,929)	\$ (6,868)
Portion of loss recognized in other comprehensive income (before taxes)	8,900	—	10,024	—
Net other-than-temporary impairment losses on fixed maturities recognized in earnings	(1,890)	(6,494)	(3,905)	(6,868)
Fixed maturities- all other	(2,718)	(1,352)	(2,701)	(1,735)
Fixed maturities, net	(4,608)	(7,846)	(6,606)	(8,603)
Equity securities	—	—	—	—
Commercial mortgage loans	(160)	(109)	(570)	(219)
Joint ventures and limited partnerships	—	—	—	—
Derivatives	3,432	4,180	10,352	292
Other	—	—	—	—
Realized investment gains (losses), net	<u>\$ (1,336)</u>	<u>\$ (3,775)</u>	<u>\$ 3,176</u>	<u>\$ (8,530)</u>

7. INVESTMENTS (continued)

Net Unrealized Investment Gains (Losses)

Net unrealized investment gains and losses on securities classified as “available for sale” and certain other long-term investments and other assets are included in the Statements of Financial Position as a component of “Accumulated other comprehensive income (loss),” or “AOCI.” Changes in these amounts include reclassification adjustments to exclude from “Other comprehensive income (loss)” those items that are included as part of “Net income” for a period that had been part of “Other comprehensive income (loss)” in earlier periods. The amounts for the periods indicated below, split between amounts related to fixed maturity securities on which an OTTI loss has been recognized, and all other net unrealized investment gains and losses, are as follows:

Net Unrealized Investment Gains and Losses on Fixed Maturity Securities on which an OTTI loss has been recognized

	Net Unrealized Gains (Losses) On Investments	Deferred Policy Acquisition Costs	Policy Holder Account Balance	Deferred Income Tax (Liability) Benefit	Accumulated Other Comprehensive Income (Loss) Related To Net Unrealized Investment Gains (Losses)
	(in thousands)				
Balance, December 31, 2008	\$ —	\$ —	\$ —	\$ —	\$ —
Cumulative impact of the adoption of FSP FAS115-2 and FAS124-2	(4,049)	290		1,316	(2,443)
Net investment gains (losses) on investments arising during the period	1,136			(398)	738
Reclassification adjustment for OTTI losses included in net income (1)	334			(117)	217
Reclassification adjustment for OTTI losses excluded from net income	(11,622)			4,068	(7,554)
Impact of net unrealized investment (gains) losses on deferred policy acquisition costs		7,660		(2,681)	4,979
Impact of net unrealized investment (gains) losses on Policy Holder account balance					
Balance, June 30, 2009	<u>\$ (14,201)</u>	<u>\$ 7,950</u>	<u>\$ —</u>	<u>\$ 2,188</u>	<u>\$ (4,063)</u>

(1) Represents “transfers in” related to the portion of OTTI losses recognized during the period that were not recognized in earnings for securities with no prior OTTI loss.

All Other Net Unrealized Investment Gains and Losses

	Net Unrealized Gains (Losses) On Investments ⁽¹⁾	Deferred Policy Acquisition Costs	Policy Holder Account Balance	Deferred Income Tax (Liability) Benefit	Accumulated Other Comprehensive Income (Loss) Related To Net Unrealized Investment Gains (Losses)
	(in thousands)				
Balance, December 31, 2008	\$ (70,920)	\$ 41,193	\$(17,457)	\$ 16,514	\$ (30,670)
Cumulative impact of the adoption of FSP FAS115-2 and FAS124-2	(2,016)	33		694	(1,289)
Net investment gains (losses) on investments arising during the period	42,632			(14,912)	27,711
Reclassification adjustment for (gains) losses included in net income	6,271			(2,195)	4,076
Reclassification adjustment for OTTI losses excluded from net income (2)	11,622			(4,086)	7,554
Impact of net unrealized investment (gains) losses on deferred policy acquisition costs and valuation of business acquired		(34,044)		11,915	(22,129)
Impact of net unrealized investment (gains) losses on Policy Holder account balance			10,435	(3,652)	6,783
Balance, June 30, 2009	<u>\$ (12,410)</u>	<u>\$ 7,182</u>	<u>\$ (7,022)</u>	<u>\$ 4,287</u>	<u>\$ (7,963)</u>

(1) Include cash flow hedges. See Note 8 for information on cash flow hedges.

(2) Represents “transfers out” related to the portion of OTTI losses recognized during the period that were not recognized in earnings for securities with no prior OTTI loss.

Notes to Unaudited Interim Financial Statement

7. INVESTMENTS (continued)

The table below presents net unrealized gains (losses) on investments by asset class as of the dates indicated:

	June 30, 2009	December 31, 2008
	(in thousands)	
Fixed maturity securities on which an OTTI loss has been recognized	\$(14,201)	\$ —
Fixed maturity securities, available for sale – all other	\$(11,877)	\$ (69,973)
Equity securities, available for sale	(864)	—
Derivatives designated as cash flow hedges ⁽¹⁾	(141)	—
Other investments	473	(947)
Net unrealized (losses) on investments	<u>\$(26,610)</u>	<u>\$ (70,920)</u>

(1) See Note 8 for more information on cash flow hedges.

Duration of Gross Unrealized Loss Positions for Fixed Maturities and Equity Securities

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

	June 30, 2009					
	Less than twelve months		Twelve months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)					
Fixed maturities available for sale						
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$ 67,319	\$ 224	\$ —	\$ —	\$ 67,319	\$ 224
Obligations of U.S. states and their political subdivisions	—	—	—	—	—	—
Foreign government bonds	—	—	—	—	—	—
Corporate securities	91,649	3,237	198,148	17,071	289,797	20,308
Commercial mortgage-backed securities	5,789	111	68,159	6,209	73,948	6,320
Asset-backed securities	14,322	14,461	14,644	2,045	28,966	16,506
Residential mortgage-backed securities	1,683	600	—	—	1,683	600
Total	<u>\$ 180,762</u>	<u>\$ 18,633</u>	<u>\$ 280,951</u>	<u>\$ 25,325</u>	<u>\$ 461,713</u>	<u>\$ 43,958</u>
Equity Securities, available for sale	<u>\$ 1,376</u>	<u>\$ 319</u>	<u>\$ 1,360</u>	<u>\$ 640</u>	<u>\$ 2,736</u>	<u>\$ 959</u>
	December 31, 2008					
	Less than twelve months		Twelve months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)					
Fixed maturities available for sale						
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Obligations of U.S. states and their political subdivisions	—	—	—	—	—	—
Foreign government bonds	1,846	7	—	—	1,846	7
Corporate securities	267,313	30,123	52,180	19,223	319,493	49,346
Commercial mortgage-backed securities	72,251	12,083	14,071	3,027	86,322	15,110
Asset-backed securities	69,126	14,593	7,000	4,235	76,125	18,827
Residential mortgage-backed securities	1,444	782	205	201	1,649	983
Total	<u>\$ 411,980</u>	<u>\$ 57,588</u>	<u>\$ 73,456</u>	<u>\$ 26,686</u>	<u>\$ 485,435</u>	<u>\$ 84,273</u>
Equity Securities, available for sale	<u>\$ 2,688</u>	<u>\$ 1,334</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 2,688</u>	<u>\$ 1,334</u>

7. INVESTMENTS (continued)

As of June 30, 2009 and December 31, 2008, gross unrealized losses on fixed maturities and equity securities were comprised of \$45 million and \$84 million of gross unrealized losses and \$18 million and \$14 million of gross unrealized gains. Gross unrealized losses includes \$26 million of gross losses that have been in such a position for twelve months or greater. In accordance with its policy described in Note 3, the Company concluded that an adjustment to earnings for other-than-temporary impairments for these securities was not warranted at June 30, 2009 or December 31, 2008. The gross unrealized losses are primarily attributable to credit spread widening and increased liquidity discounts. At June 30, 2009, the Company does not intend to sell the security and it is not more likely than not that the Company will be required to sell the securities before the anticipated recovery of its remaining amortized cost basis.

8. DERIVATIVE INSTRUMENTS

Types of Derivative Instruments and Derivative Strategies

Interest rate swaps are used by the Company to manage interest rate exposures arising from mismatches between assets and liabilities (including duration mismatches) and to hedge against changes in the value of assets it anticipates acquiring and other anticipated transactions and commitments. Swaps may be attributed to specific assets or liabilities or may be used on a portfolio basis. Under interest rate swaps, the Company agrees with other parties to exchange, at specified intervals, the difference between fixed rate and floating rate interest amounts calculated by reference to an agreed upon notional principal amount. Generally, no cash is exchanged at the outset of the contract and no principal payments are made by either party. These transactions are entered into pursuant to master agreements that provide for a single net payment to be made by one counterparty at each due date.

Exchange-traded futures are used by the Company to reduce risks from changes in interest rates, to alter mismatches between the duration of assets in a portfolio and the duration of liabilities supported by those assets, and to hedge against changes in the value of securities it owns or anticipates acquiring or selling. In exchange-traded futures transactions, the Company agrees to purchase or sell a specified number of contracts, the values of which are determined by the values of underlying referenced securities, and to post variation margin on a daily basis in an amount equal to the difference in the daily market values of those contracts. The Company enters into exchange-traded futures transactions with regulated futures commissions merchants that are members of a trading exchange.

Futures typically are used to hedge duration mismatches between assets and liabilities. Futures move substantially in value as interest rates change and can be used to either modify or hedge existing interest rate risk.

Currency derivatives, including currency swaps, are used by the Company to reduce risks from changes in currency exchange rates with respect to investments denominated in foreign currencies that the Company either holds or intends to acquire or sell.

Under currency swaps, the Company agrees with other parties to exchange, at specified intervals, the difference between one currency and another at an exchange rate and calculated by reference to an agreed principal amount. Generally, the principal amount of each currency is exchanged at the beginning and termination of the currency swap by each party. These transactions are entered into pursuant to master agreements that provide for a single net payment to be made by one counterparty for payments made in the same currency at each due date.

Credit derivatives are used by the Company to enhance the return on the Company's investment portfolio by creating credit exposure similar to an investment in public fixed maturity cash instruments. With credit derivatives the Company can sell credit protection on an identified name, or a basket of names in a first to default structure, and in return receive a quarterly premium. With first to default baskets, the premium generally corresponds to a high proportion of the sum of the credit spreads of the names in the basket. If there is an event of default by the referenced name or one of the referenced names in a basket, as defined by the agreement, then the Company is obligated to pay the counterparty the referenced amount of the contract and receive in return the referenced defaulted security or similar security. In addition to selling credit protection, the Company may purchase credit protection using credit derivatives in order to hedge specific credit exposures in the Company's investment portfolio.

The Company uses "to be announced" ("TBA") forward contracts to gain exposure to the investment risk and return of mortgage-backed securities. TBA transactions can help the Company to achieve better diversification and to enhance the return on its investment portfolio. TBAs provide a more liquid and cost effective method of achieving these goals than purchasing or selling individual mortgage-backed pools. Typically, the price is agreed upon at the time of the contract and payment for such a contract is made at a specified future date.

8. DERIVATIVE INSTRUMENTS (continued)

Embedded Derivatives

The Company sells variable annuity products, which contain embedded derivatives. The Company has reinsurance agreements to transfer the risk related to the embedded derivatives to affiliates. These embedded derivatives are marked to market through “Realized investment gains (losses), net” based on the change in value of the underlying contractual guarantees, which are determined using valuation models. In the affiliates, the Company maintains a portfolio of derivative instruments that is intended to economically hedge the risks related to the above products’ features. The derivatives may include, but are not limited to equity options, total return swaps, interest rate swap options, caps, floors, and other instruments. Also, some variable annuity products feature an automatic rebalancing element to minimize risks inherent in the Company’s guarantees which reduces the need for hedges. In addition to the hedging of guaranteed risks by Pruco Re, the Company started hedging the risk associated with the guaranteed minimum death benefits feature and employs similar types of hedging instruments as described above.

The Company invests in fixed maturities that, in addition to a stated coupon, provide a return based upon the results of an underlying portfolio of fixed income investments and related investment activity. The Company accounts for these investments as available for sale fixed maturities containing embedded derivatives. Such embedded derivatives are marked to market through “Realized investment gains (losses), net,” based upon the change in value of the underlying portfolio.

The table below provides a summary of the gross notional amount and fair value of derivatives contracts, excluding embedded derivatives which are recorded with the associated host, by the primary underlying. Many derivative instruments contain multiple underlyings.

	June 30, 2009			December 31, 2008		
	Notional Amount	Fair Value		Notional Amount	Fair Value	
		Assets	Liabilities		Assets	Liabilities
		(in thousands)				
Qualifying Hedge Relationships						
Currency/Interest Rate	\$ 5,366	\$ —	(140)	\$ 1,144	\$ 35	\$ —
Total Qualifying Hedge Relationships	<u>\$ 5,366</u>	<u>\$ —</u>	<u>\$ (140)</u>	<u>\$ 1,144</u>	<u>\$ 35</u>	<u>\$ —</u>
Non-qualifying Hedge Relationships						
Interest Rate	\$47,000	\$ 3	\$(3,637)	\$ —	\$ —	\$ —
Credit	33,949	3,879	(1,790)	\$27,950	\$3,157	\$(4,272)
Currency/Interest Rate	9,115	312	(266)	\$ 2,400	\$ —	\$(123)
Total Non-qualifying Hedge Relationships	<u>\$90,064</u>	<u>\$4,194</u>	<u>\$(5,693)</u>	<u>\$30,350</u>	<u>\$3,157</u>	<u>\$(4,395)</u>
Total Derivatives (1)	<u>\$95,430</u>	<u>\$4,194</u>	<u>\$(5,833)</u>	<u>\$31,494</u>	<u>\$3,192</u>	<u>\$(4,395)</u>

(1) Excludes embedded derivatives which contain multiple underlyings. The fair value of these embedded derivatives as of June 30, 2009 was a liability of \$18 million and a liability of \$68 million as of December 31, 2008 included in future policy benefits.

8. DERIVATIVE INSTRUMENTS (continued)

Cash Flow Hedges

The Company uses currency swaps in its cash flow hedge accounting relationships. This instrument is only designated for hedge accounting in instances where the appropriate criteria are met. The Company does not use futures, options, credit, and equity or embedded derivatives in any of its cash flow hedge accounting relationships.

The following table provides the financial statement classification and impact of derivatives used in qualifying and non-qualifying hedge relationships,

	Three Months Ended June 30, 2009	Six Months Ended June 30, 2009
	(in thousands)	
Cash flow hedges		
<i>Currency/ Interest Rate</i>		
Net investment income	4.8	5.0
Other Income	(1.3)	(.3)
Accumulated Other Comprehensive Income (1)	—	—
Total cash flow hedges.	\$ 3.5	\$ 4.7
Non-qualifying hedges		
Realized investment gains (losses)		
Interest Rate	\$ (5,193)	\$ (5,624)
Currency/Interest Rate	24	60
Credit	1,982	2,381
Embedded Derivatives	6,619	13,535
Total non-qualifying hedges	\$ 3,432	\$ 10,352
Total Derivative Impact	<u>\$ 3,435</u>	<u>\$ 10,357</u>

(1) Amounts deferred in Stockholders' Equity

For the period ending June 30, 2009, the ineffective portion of derivatives accounted for using hedge accounting was not material to the Company's results of operations and there were no material amounts reclassified into earnings relating to instances in which the Company discontinued cash flow hedge accounting because the forecasted transaction did not occur by the anticipated date or within the additional time period permitted by SFAS No. 133.

Presented below is a roll forward of current period cash flow hedges in "Accumulated other comprehensive income (loss)" before taxes:

	(in thousands)
Balance, December 31, 2008	\$ 36
Net deferred gains on cash flow hedges from January 1 to June 30, 2009	(182)
Amount reclassified into current period earnings	5
Balance, June 30, 2009	<u>\$ (141)</u>

As of June 30, 2009, the Company does not have any qualifying cash flow hedges of forecasted transactions other than those related to the variability of the payment or receipt of interest or foreign currency amounts on existing financial instruments. The maximum length of time for which these variable cash flows are hedged is 7 years. Income amounts deferred in "Accumulated other comprehensive income (loss)" as a result of cash flow hedges are included in "Net unrealized investment gains (losses)" in the Consolidated Statements of Stockholders' Equity

8. DERIVATIVE INSTRUMENTS (continued)

Credit Derivatives Written

The following tables set forth our exposure from credit derivatives where we have written credit protection excluding embedded derivatives contained in externally-managed investments in the European market, by NAIC rating of the underlying credits as of the dates indicated.

NAIC Designation	Rating Agency Equivalent	June 30, 2009	
		First to default Basket(1)	
		Notional	Fair Value
		(in millions)	
1	Aaa, Aa, A	\$ 2	\$ —
2	Baa	7	(1)
	Subtotal Investment Grade	9	(1)
3	Ba	12	(1)
4	B	—	—
5	C and lower	—	—
6	In or near default	—	—
Total		\$ 21	\$ (2)

NAIC Designation	Rating Agency Equivalent	December 31, 2008	
		First to Default Basket (1)	
		Notional	Fair Value
		(in millions)	
1	Aaa, Aa, A	\$ 2.0	\$ (.2)
2	Baa	19.0	(4.0)
	Subtotal Investment Grade	21.0	(4.2)
3	Ba	—	—
4	B	—	—
5	C and lower	—	—
6	In or near default	—	—
Total		\$ 21.0	\$ (4.2)

- (1) First-to-default credit swap baskets, which may include credits of varying qualities, are grouped above based on the lowest credit in the basket. However, such basket swaps may entail greater credit risk than the rating level of the lowest credit.

8. DERIVATIVE INSTRUMENTS (continued)

The following table sets forth the composition of our credit derivatives where we have written credit protection excluding embedded derivatives contained in externally-managed investments in the European market, by industry category as of the dates indicated.

Industry	June 30, 2009		December 31, 2008	
	Notional	Fair Value	Notional	Fair Value
	(in millions)			
Corporate Securities:				
First to Default Baskets(1)	\$ 21.0	\$ (2.0)	\$ 21.0	\$ (4.2)
Total Credit Derivatives	<u>\$ 21.0</u>	<u>\$ (2.0)</u>	<u>\$ 21.0</u>	<u>\$ (4.2)</u>

(1) Credit default baskets may include various industry categories.

The Company writes credit derivatives under which the Company is obligated to pay the counterparty the referenced amount of the contract and receive in return the defaulted security or similar security. The Company's maximum amount at risk under these credit derivatives, assuming the value of the underlying referenced securities become worthless, is \$21 million notional of credit default swap ("CDS") selling protection at June 30, 2009. These credit derivatives generally have maturities of five years or less.

The Company holds certain externally managed investments in the European market which contain embedded derivatives whose fair value are primarily driven by changes in credit spreads. These investments are medium term notes that are collateralized by investment portfolios primarily consisting of investment grade European fixed income securities, including corporate bonds and asset-backed securities, and derivatives, as well as varying degrees of leverage. The notes have a stated coupon and provide a return based on the performance of the underlying portfolios and the level of leverage. The Company invests in these notes to earn a coupon through maturity, consistent with its investment purpose for other debt securities. The notes are accounted for under U.S. GAAP as available for sale fixed maturity securities with bifurcated embedded derivatives (total return swaps). Changes in the value of the fixed maturity securities are reported in Stockholders' Equity under the heading "Accumulated Other Comprehensive Income" and changes in the market value of the embedded total return swaps are included in current period earnings in "Realized investment gains (losses), net." The Company's maximum exposure to loss from these interests was \$5 million at June 30, 2009 and December 31, 2008, respectively.

In addition to writing credit protection, the Company has purchased credit protection using credit derivatives in order to hedge specific credit exposures in the Company's investment portfolio. As of June 30, 2009 the Company had \$13 million of outstanding notional amounts, reported at fair value as an asset of \$4 million.

Credit Risk

The Company is exposed to credit-related losses in the event of non-performance by counterparties to financial derivative transactions. Substantially all of the Company's over-the-counter derivative contracts are transacted with an affiliate. In instances where the Company transacts with unaffiliated counterparties, the Company manages credit risk by entering into derivative transactions with major international financial institutions and other creditworthy counterparties, and by obtaining collateral where appropriate. Additionally, limits are set on single party credit exposures which are subject to periodic management review.

The credit exposure of the Company's over-the-counter derivative transactions is represented by the contracts with a positive fair value (market value) at the reporting date. The Company effects exchange-traded futures transactions through regulated exchanges and these transactions are settled on a daily basis, thereby reducing credit risk exposure in the event of nonperformance by counterparties to such financial instruments.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Pruco Life Insurance Company of New Jersey meets the conditions set forth in General Instruction H(1)(a) and (b) on Form 10-Q and therefore is filing this form with the reduced disclosure format.

This Management's Discussion and Analysis, or "MD&A," of Financial Condition and Results of Operations addresses the financial condition of the Company, as of June 30, 2009, compared with December 31, 2008, and its results of operations for the three month periods ended June 30, 2009 and June 30, 2008. You should read the following analysis of our financial condition and results of operations in conjunction with the "Risk Factors" section, the MD&A and the audited Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008, as well as the Forward-Looking Statements and the Unaudited Interim Financial Statements included elsewhere in this Quarterly Report on Form 10-Q.

Overview

The Company sells interest-sensitive individual life insurance and variable life insurance, term life insurance and individual variable annuities, primarily through Prudential Insurance's sales force in New Jersey and New York. These markets are subject to regulatory oversight, with particular emphasis placed on company solvency and sales practices. These markets are also subject to increasing competitive pressure as the legal barriers, that have historically segregated the markets of the financial services industry, have been changed. Regulatory changes have opened the insurance industry to competition from other financial institutions, particularly banks and mutual funds that are positioned to deliver competing investment products through large, stable distribution channels.

Products*Variable Life Insurance*

The Company offers a number of individual variable life insurance products which represents 21% of its net individual life insurance in force at the end of June 30, 2009. Variable products provide a return linked to an underlying investment portfolio selected by the policyholder while providing the policyholder with the flexibility to change both the death benefit and premium payments. The policyowner generally has the option of investing premiums in a fixed rate option that is part of the Company's general account. The Company guarantees that funds invested in the fixed rate option will accrue interest at a rate established by the Company generally based on our portfolio rate. The policyowner can also invest in separate account investment options consisting of equity and fixed income funds. Returns on the separate account funds are not guaranteed and the policyholder bears the fund performance risk. Each product provides for the deduction of charges and expenses from the customer's investment account. While variable life insurance continues to be an important product, marketplace demand continues to favor term and universal life insurance.

A significant portion of our Individual Life insurance profits are associated with the large in force block of variable policies. Profit patterns on these policies are not level and as the policies age, insureds begin paying reduced policy charges. This, coupled with net policy count and insurance in force runoff over time, reduces our expected future profits from this product line. Asset administration fees and mortality and expense fees are a key component of variable life product profitability and vary based on the average daily net asset value.

Due to policyholder options under some of the variable life contracts, lapses may occur on a quarter lag with the market risk during this lag being borne by the Company. Consequently, due to the continued unfavorable equity markets in the first quarter of 2009, the variable life policy lapses negatively impacted results. Since a significant portion of our life profits are related to variable policies, this accelerated run off could adversely impact future profits.

Term Life Insurance

The Company offers a variety of term life insurance products which represents 73% of our net individual life insurance in force at the end of June 30, 2009. Most term products include a conversion feature that allows the policyholder to convert the policy into permanent life insurance coverage. The Company also offers term life insurance that provides for a return of premium if the insured is alive at the end of the level premium period. There continues to be significant marketplace demand for term life insurance protection.

Individual Life profits from term insurance are not expected to directly correlate, from a timing perspective, with the increase in term insurance in force because of uneven product profitability patterns.

Universal Life Insurance

The Company offers universal life insurance products which represents 6% of our net individual life insurance in force at the end of June 30, 2009. Universal life insurance products feature a fixed crediting rate that varies periodically based on portfolio returns as well as flexible premiums and a choice of guarantees against lapse. Universal Life policies provide for the deduction of charges and expenses from the customer's contract fund. Individual Life profits from universal life insurance are impacted by mortality, policyholder persistency, expense margins, and interest spread on policyholder funds.

Variable and Fixed Annuities

The Company offers a wide array of annuities, including deferred variable annuities that are registered with the SEC, which may include (1) fixed interest rate allocation options, subject to a market value adjustment, and registered with the SEC, and (2) fixed interest rate allocation options not subject to a market value adjustment and not registered with the SEC.

The Company offers variable annuities that provide its customers with tax-deferred asset accumulation together with a full suite of optional guaranteed death and living benefits. The optional benefit features contractually guarantee the contractholder a return of no less than (1) total deposits made to the contract less any partial withdrawals ("return of net deposits"), (2) total deposits made to the contract less any partial withdrawals plus a minimum return ("minimum return"), and/or (3) the highest contract value on a specified date minus any withdrawals ("contract value"). These guarantees may include benefits that are payable in the event of death, annuitization or at specified dates during the accumulation period and withdrawal and income benefits payable during specified periods. Our variable annuity investment options provide our customers with the opportunity to invest in proprietary and non-proprietary mutual fund sub-accounts, frequently under asset allocation programs, and fixed-rate options. The investments made by customers in the proprietary and non-proprietary mutual funds represent an interest in separate investment companies that provide a return linked to an underlying investment portfolio. The investments made in the fixed rate options are credited with interest at rates we determine, subject to certain minimums.

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 equity market returns, interest rates, market volatility, timing of annuitization and withdrawals, contract lapses and contractholder mortality. As part of our risk management strategy we hedge or limit our exposure to these risks, excluding those risks we have deemed suitable to retain, through a combination of product design elements, such as an automatic allocation element, and reinsurance programs to affiliates. The automatic allocation element included in the design of certain optional benefit features offered under variable annuity products transfers assets between contractholder sub-accounts depending on a number of factors, including the investment performance of the sub-accounts. Negative investment performance may result in transfers to either a fixed-rate general account option or a separate account bond portfolio. In certain situations, assets may transfer back when investment performance improves. Other product design elements we utilize for certain products to manage these risks include asset allocation and minimum purchase age requirements.

Variable annuity account values with living benefit features were \$580 million and \$471 million as of June 30, 2009 and 2008, respectively. For risk management purposes, in addition to reinsurance of living benefit features to Pruco Reinsurance, Ltd. (Pruco Re.) we segregate our variable annuity living benefit features into three broad product groupings, described in more detail below: (1) those where we utilize an automatic allocation element, (2) those where we utilize only capital markets hedging and (3) those with risks we have deemed suitable to retain.

- (1) We manage the equity market, interest rate and market volatility risks associated with our Highest Daily products by utilizing both an automatic allocation element and capital markets hedging. Our Highest Daily optional living benefits guarantee, among other features, the ability to make withdrawals based on the highest daily contract value plus a minimum return credited for a period of time. This guaranteed value is accessible through withdrawals for the life of the contractholder (or joint lives, for the spousal version of the benefit,) and not as a lump-sum surrender value. For our Highest Daily products we utilize an automatic allocation element to limit our exposure to equity market risk and market volatility. Asset allocation and minimum purchase age requirements are also included in the design of our Highest Daily products to limit our exposure to equity market risk and market volatility. Contracts with living benefit features where we utilize an automatic allocation element represented \$288 million or 50%, and \$94 million or 20% of our variable annuity account values with living benefit features as of June 30, 2009 and 2008, respectively.
- (2) We manage the risks associated with other accumulation and withdrawal guarantees through reinsurance agreements with Pruco Re. The Company has entered into reinsurance agreements to transfer the risk related to these guarantees with Pruco Re. In Pruco Re, we manage the risks associated with all other withdrawal guarantees through capital markets hedging. Pruco Re actively hedges these guarantees for changes in equity markets, interest rates, and market volatility through the use of equity options and interest rate derivatives. Contracts with living benefit features utilizing capital markets hedging represented \$199 million or 34%, and \$246 million or 52% of our variable annuity account values with living benefit features as of June 30, 2009 and 2008, respectively. As a result of the volatility and disruption in the global financial markets, we have ceased sales of certain of these products.
- (3) We have deemed the risks associated with our guaranteed minimum income benefits suitable to retain. Our guaranteed minimum income benefits guarantee a minimum return on the contract value or an enhanced value, if applicable, to be used for purposes of determining annuity income payments. Contracts with living benefit features and only with risks we have deemed suitable to retain represented \$93 million or 16%, and \$131 million or 28% of our variable annuity account values with living benefit features as of June 30, 2009 and 2008 respectively.

We have deemed the risks associated with our guaranteed minimum death benefits suitable to retain. Our guaranteed minimum death benefits guarantee a minimum return on the contract value or an enhanced value, if applicable, to be used for purposes of determining benefits payable in the event of death. All of the \$580 million and \$471 million of variable annuity account values with living benefit features as of June 30, 2009 and 2008, respectively, also contain guaranteed minimum death benefits, with \$288 million or 50% and \$94 million or 20% benefiting from an automatic allocation element, as discussed above. An additional \$564 million and \$745 million of variable annuity account values as of June 30, 2009 and 2008, respectively, contain guaranteed minimum death benefits, but no living benefit features.

The Company earns its profits through policy fees charged to separate account annuity and life policyholders and through the interest spread for general account annuity and life products. Policy charges and fee income consist mainly of three types: sales charges or loading fees on new sales, mortality and expense charges, or "M&E", assessed on fund balances, and mortality and related charges based on total life insurance in force business. Policyholder fund values are affected by net sales (sales less withdrawals), changes in interest rates, and investment returns.

The Company also earns profits from the interest spread earned on general account products. The interest spread represents the difference between the investment income earned by the Company on its investment portfolio and the amount of interest credited to policyholders' accounts. Products that generate interest spread primarily include general account life insurance products, fixed annuities and the fixed-rate option of variable annuities.

In addition to policy charges and fee income, the Company earns revenues from insurance premiums from term life insurance and asset administration fees from separate account fund balances. The Company's benefits and expenses principally consist of insurance benefits provided, general business expenses, commissions and other costs of selling and servicing the various products the Company sells and interest credited to policyholders' account balances.

1. Changes in Financial Position

June 30, 2009 versus December 31, 2008

Total assets increased \$346 million, from \$4.234 billion at December 31, 2008 to \$4.580 billion at June 30, 2009. The largest increase was in separate account assets, which increased \$220 million, from \$2.306 billion at December 31, 2008 to \$2.526 billion at June 30, 2009, primarily driven by improvement in equity market performance during the current year.

Fixed maturities increased by \$155 million from \$796 million at December 31, 2008 to \$951 million at June 30, 2009. This increase was primarily driven by transfers from our separate account to our general account due to an automatic allocation element in certain of our living benefit features on our annuity products. Also contributing to the increase was continued reinvestment of cash flows from business operations and reinvestment of investment income.

Deferred policy acquisition costs decreased by \$24 million from \$327 million at December 31, 2008, to \$303 million at June 30, 2009, primarily due to \$22 million in amortization primarily resulting from the impact of the change in non-performance risk discussed above. We amortize deferred policy acquisition and other costs associated with variable and universal life policies and the variable and fixed annuity contracts over the expected lives of the contracts based on the level and timing of gross profits on the underlying product. In calculating gross profits, we consider mortality, persistency, and other elements as well as rates of return on investments associated with these contracts and include profits and losses related to these contracts that are reported in affiliated legal entities other than the Company as a result of, for example, reinsurance agreements with those affiliated entities. This amortization is partially offset by \$24 million of capitalization of acquisition costs from the continued growth of sales in life and annuity products. Shadow DAC decreased \$26 million from decreased unrealized losses.

Reinsurance recoverables decreased by \$5 million from \$301 million at December 31, 2008 to \$296 million at June 30, 2009 driven by a change in the reinsured liability for living benefit embedded derivatives resulting from updates of inputs used in the valuation of the embedded derivatives under SFAS 157. Under SFAS 157 we are required to incorporate our own risk of non-performance in the valuation of the embedded derivatives associated with our living benefit. In light of 2009 developments, including rating agency downgrades to the claims-paying ratings, we updated the discount rate used in these valuations to reflect the market-perceived increase in our non-performance risk. In light of first quarter 2009 developments, we used a higher discount rate in the valuation as a result of the increase in our non-performance risk, thereby reducing the value of the embedded derivative liabilities. This was partially offset by increased reinsurance recoverables due to continued growth in the term life in force covered under the Prudential Arizona Reinsurance Captive Company "PARCC" agreement.

During the first six months of 2009, total liabilities increased by \$311 million, from \$3.820 billion at December 31, 2008 to \$4.131 billion at June 30, 2009, primarily due to an increase in separate account liabilities of \$220 million, primarily driven by improvement in equity market performance. Policyholder account balances increased \$72 million, from \$910 million at December 31, 2008 to \$982 million at June 30, 2009 primarily driven by transfers from the Company's separate account to its general account, continued growth in universal life in force and the automatic rebalancing element on certain living benefit features. Future policy benefits and other policyholder liabilities decreased by \$17 million, from \$458 million at December 31, 2008 to \$441 million at June 30, 2009 primarily driven by a decrease in the liability for living benefit embedded derivatives resulting from the valuation

of the embedded derivatives under SFAS 157, partially offset by higher life reserves as a result of in force growth of term products. Total securities lending activities decreased by \$22 million from \$39 million at December 31, 2008 to \$17 million at June 30, 2009. The relative amounts of cash collateral for loaned securities and securities sold under agreements to repurchase decreased \$2 million and decreased \$20 million, respectively.

2. Results of Operations

2009 to 2008 Three Month Comparison

Net Income

Net income increased \$14 million, from \$9 million for the three months ended June 30, 2008 to \$24 million for the three months ended June 30, 2009. This is driven by a \$19 million gain from operations before income taxes partially offset by a \$4 million increase in income tax expense primarily driven by the change in non-performance risk used in the valuation of embedded derivatives under FAS 157.

Income (Loss) from operations before income taxes for the three months ended June 30, 2009 included a \$14 million favorable variance in the amortization of deferred policy acquisition and other costs driven by a decrease in the living benefit embedded derivatives liability driven by the impact of the change in non-performance risk used in the valuation of embedded derivatives under FAS 157, as discussed above.

Income from operations before income taxes for the three months ended June 30, 2009 also included a benefit of \$5 million related to the quarterly market performance adjustments to the reserves for the guaranteed minimum death and income benefit features on variable annuity products used to estimate of total gross profits used as a basis for amortizing deferred policy acquisition and other costs. The \$5 million benefit, includes \$3 million relating to reserve decreases for the guaranteed minimum death and income benefit features on variable annuity products and \$2 million relating to decreased amortization of deferred policy acquisition and other costs, reflect market performance related adjustments to the estimate of total gross profits to reflect actual fund performance in the second quarter of 2009. In light of recent market conditions, beginning in the fourth quarter of 2008 we determined that adjustments to estimates of total gross profits to reflect actual fund performance and any corresponding changes to the future rate of return assumptions should no longer be dependent on a comparison to a statistically generated range of estimated gross profits. Instead, for purposes of evaluating deferred policy acquisition and other costs and the reserves for the guaranteed minimum death and income benefit features of variable annuity products, total estimated gross profits are updated for these items each quarter. The better than expected market return in the second quarter of 2009 increased our estimates of total gross profits by establishing a new, higher starting point for the variable annuity account values used in estimating gross profits for future periods. The previously expected rate of return for the second quarter of 2009 was based upon our current maximum future rate of return assumption under the reversion to the mean approach, as discussed below. The increase in our estimate of total gross profits results in a lower required rate of amortization, which is applied to all prior periods' gross profits. The resulting cumulative adjustment to prior amortization is recognized in the current period. In addition, the lower rate of amortization will also be applied to future gross profits in calculating amortization in future periods which, all else being equal will result in higher net profits in future periods.

We continue to derive future rate of return assumptions using a reversion to the mean approach, a common industry practice for variable life and variable annuity products. Under this approach, we consider actual returns over a period of time and initially adjust future projected returns so that the assets grow at the long term expected rate of return for the entire period. However, by the end of 2008, the projected future rate of return calculated using the reversion to the mean approach was greater than 10.9% on life products and 10.5% on annuity products, the current maximum future rate of return assumptions across all asset types for these businesses. In those cases, we utilize the maximum future rate of return over the four year period, thereby limiting the impact of the reversion to the mean on our estimate of total gross profits. Further or continued market volatility could result in additional market value changes within our separate account assets and corresponding changes to our gross profits, as well as additional adjustments to the amortization of deferred policy acquisition and other costs, and the costs relating to the reserves for the guaranteed minimum death and income benefit features of our variable annuity products. Given that the estimates of future gross profits are based upon our maximum future rate of return assumption for most contract groups as discussed above, all else being equal, future quarterly rates of return higher or lower than 2.6% will result in decreases or increases in the amortization of deferred policy acquisition and other costs, and the costs relating to the reserves for the guaranteed minimum death and income benefit features of our variable annuity products.

Absent the effect of the change in non-performance risk in the valuation of embedded derivatives under FAS 157 and market performance adjustments discussed above, Income (Loss) from operations before income taxes for the three months ended June 30, 2009 decreased \$1 million from the three months ended June 30, 2008, the decrease was primarily due to lower policy charges and fee income driven by lower average asset balances invested in separate accounts.

Revenues

Revenues decreased by \$2 million, from \$38 million in the three months ended June 30, 2008, to \$36 million for the three months ended June 30, 2009. This decrease is primarily driven by Policy charges and fee income, which consist primarily of mortality and expense charges, loading and other insurance charges assessed on general and separate account policyholders' fund balances that decreased by \$4 million, from \$18 million three months ended June 30, 2008, to \$14 million for the three months ended June 30, 2009 due to a decrease in average daily separate account assets. This decrease was primarily offset by realized gains of \$2 million on reinsurance of living benefit features to affiliates.

Benefits and Expenses

Total benefits and expenses of \$6 million for the three months ended June 30, 2009 decreased by \$20 million, from \$26 million for the three months ended June 30, 2008.

Amortization of deferred policy acquisition costs decreased by \$13 million from \$7 million for the three months ended June 30, 2008 to \$(6) for the three months ended June 30, 2009. The decrease was driven by lower amortization of deferred policy acquisition costs of \$10 million primarily due to the impact of the change in non-performance risk in the valuation of embedded derivatives under FAS 157 and reversion to the mean assumptions as discussed above. Also contributing to the decrease was a benefit of \$5 million related to the quarterly market performance adjustments and reversion to the mean assumptions. Absent the effect of the change in non-performance risk in the valuation of embedded derivatives under FAS 157, market performance adjustments and reversion to the mean assumptions, as discussed above deferred policy acquisition costs expenses increased \$2 million for the three months ended June 30, 2009, primarily driven by higher amortization of deferred acquisition costs due to unfavorable variable life product persistency, partially offset by lower amortization due to favorable fund performance.

General, administrative and other expenses decreased by \$2 million from \$6 million for the three months ended June 30, 2008 to \$4 million for the three months ended June 30, 2009, primarily driven by driven primarily driven higher net reinsurance expense allowances resulting from growth in the term business. Other business related expenses were relatively unchanged from prior year quarter.

Policyholders' benefits and expenses, including related changes in reserves, decreased by \$2 million, from \$6 million in the three months ended June 30, 2008, to \$4 million in the three months ended June 30, 2009. The decrease was mainly driven by \$3 million of benefits relating to reserve decreases for the guaranteed minimum death and income benefit of our variable annuity contracts in the second quarter, as discussed above. Absent the impacts of the market assumption reviews, policyholders' benefit and expenses, including related changes in reserves, increased \$1 million primarily due to term life reserve growth attributed to continued sales and in-force growth as well as higher policyholder claim experience.

Interest credited to policyholders' account balances decreased by \$4 million, from \$8 million in the three months ended June 30, 2008 to \$4 million for the three months ended June 30, 2009 primarily driven by decreased annuity deferred sales inducement amortization of \$5 million primarily driven by the impact of the change in non-performance risk in the valuation of embedded derivatives under FAS 157. Absent this impact interest credited to policyholders' account balances increased by \$1 million due to continued growth from life and annuity sales.

2009 to 2008 Six Month Comparison

Net Income

Net income decreased \$5 million, from \$17 million for the six months ended June 30, 2008 to \$12 million for the six months ended June 30, 2009. This is driven by a \$7 million loss from operations before income taxes partially offset by a \$2 million increase in income tax expense primarily driven by the change in non-performance risk used in the valuation of embedded derivatives under FAS 157.

Income (Loss) from operations before income taxes for the six months ended June 30, 2009 included a \$11 million unfavorable variance in the amortization of deferred policy acquisition and other costs driven by a decrease in the living benefit embedded derivatives driven by the impact of the inclusion of non-performance risk used in the valuation of embedded derivatives under FAS 157, as discussed above.

Income (Loss) from operations before income taxes for the six months ended June 30, 2009 also included a benefit of \$1 million related to the quarterly market performance adjustments to the reserves for the guaranteed minimum death and income benefit features on variable annuity products and to the estimate of total gross profits used as a basis for amortizing deferred policy acquisition and other costs. In light of recent market conditions, beginning in the fourth quarter of 2008 we determined that adjustments to estimates of total gross profits to reflect actual fund performance and any corresponding changes to the future rate of return assumptions should no longer be dependent on a comparison to a statistically generated range of estimated gross profits. Instead, for purposes of evaluating deferred policy acquisition and other costs and the reserves for the guaranteed minimum death and income benefit features of variable annuity products, total estimated gross profits are updated for these items each quarter. The market value appreciation in the first six months of 2009 increased our estimates of total gross profits by establishing a new, higher starting point for the variable annuity account values used in estimating gross profits for future periods. The increase in our estimate of total gross profits results in a lower required rate of amortization, which is applied to all prior periods' gross profits. The resulting cumulative adjustment to prior amortization is recognized in the current period.

We continue to derive future rate of return assumptions using a reversion to the mean approach, a common industry practice for variable life and variable annuity products. Under this approach, we consider actual returns over a period of time and initially adjust future projected returns so that the assets grow at the long term expected rate of return for the entire period. However, by the end of 2008, the projected future rate of return calculated using the reversion to the mean approach was greater than 10.9% on life products and 10.5% on annuity products, the current maximum future rate of return assumptions across all asset types for these businesses. In those cases, we utilize the maximum future rate of return over the four year period,

thereby limiting the impact of the reversion to the mean on our estimate of total gross profits. Further or continued market volatility could result in additional market value changes within our separate account assets and corresponding changes to our gross profits, as well as additional adjustments to the amortization of deferred policy acquisition and other costs, and the costs relating to the reserves for the guaranteed minimum death and income benefit features of our variable annuity products. Given that the estimates of future gross profits are based upon our maximum future rate of return assumption for most contract groups as discussed above, all else being equal, future quarterly rates of return higher or lower than 2.6% will result in decreases or increases in the amortization of deferred policy acquisition and other costs, and the costs relating to the reserves for the guaranteed minimum death and income benefit features of our variable annuity products.

Absent the effect of the change in non-performance risk in the valuation of embedded derivatives under FAS 157 and market performance adjustments discussed above, Income (Loss) from operations before income taxes for the six months ended June 30, 2009 increased \$7 million from the six months the three months ended June 30, 2008, driven by realized gains of \$11 million on reinsurance of living benefit features to affiliates partially offset by lower policy charges and fee income driven by lower average asset balances invested in separate accounts.

Revenues

Revenues increased by \$5 million, from \$76 million in the six months ended June 30, 2008, to \$81 million for the six months ended June 30, 2009. This increase was primarily driven by realized gains of \$11 million on reinsurance of living benefit features to affiliates. Offsetting this is policy charges and fee income, which consist primarily of mortality and expense charges, loading and other insurance charges assessed on general and separate account policyholders' fund balances that decreased by \$7 million, from \$36 million six months ended June 30, 2008, to \$29 million for the six months ended June 30, 2009 due to a decrease in average daily separate account assets.

Benefits and Expenses

Total benefits and expenses of \$65 million for the six months ended June 30, 2009 increased by \$12 million, from \$53 million for the six months ended June 30, 2008.

Amortization of deferred policy acquisition costs increased by \$5 million from \$17 million for the six months ended June 30, 2008 to \$22 for the six months ended June 30, 2009. The increase was driven by greater amortization of deferred policy acquisition costs of \$9 million primarily due to the impact of the change in non-performance risk in the valuation of embedded derivatives under FAS 157 and reversion to the mean assumptions as discussed above. Partially offset by a benefit of \$1 million related to the quarterly market performance adjustments. Absent the effect of the change in non-performance risk in the valuation of embedded derivatives under FAS 157, market performance adjustments and reversion to the mean assumptions, as discussed above deferred policy acquisition costs expenses increased \$1 million for the six months ended June 30, 2009, primarily driven by higher amortization of deferred acquisition costs due to unfavorable variable life product persistency, partially offset by lower amortization due to favorable fund performance.

General, administrative and other expenses decreased by \$2 million from \$10 million for the six months ended June 30, 2008 to \$8 for the six months ended June 30, 2009, primarily driven by higher net reinsurance expense allowances resulting from growth in the term business. Other business related expenses were relatively unchanged from prior year quarter.

Policyholders' benefit and expenses, including related changes in reserves, increased by \$3 million, from \$11 million in the six months ended June 30, 2008, to \$14 million in the six months ended June 30, 2009. The increase was mainly due to term life reserve growth attributed to continued sales and in force growth.

Interest credited to policyholders' account balances increased by \$6 million, from \$15 million in the six months ended June 30, 2008 to \$21 million for the six months ended June 30, 2009 primarily driven by increased annuity deferred sales inducement amortization of \$4 million primarily driven by the impact of the change in non-performance risk in the valuation of embedded derivatives under FAS 157. Absent this impact interest credited to policyholders' account balances increased by \$2 million due to continued growth from life and annuity sales.

Income Tax Expense

Our income tax provision amounted to an income tax expense of \$7 million in the second quarter of 2009 compared to income tax expense of \$3 million in the second quarter of 2008. The increase in income tax expense reflects the increase in pre-tax income from continuing operations before income taxes from the second quarter of 2008 to the second quarter of 2009. It also reflects a benefit in the second quarter of 2009 for a reduction to the liability for unrecognized tax benefits and interest of \$1 million primarily related to tax years prior to 2002 as a result of the expiration of the statute of limitations for the 2002 tax year.

Our income tax provision amounted to an income tax expense of \$4 million in the first six months of 2009 compared to income tax expense of \$6 million in the first six months of 2008. The expense in the first six months of 2009 reflects a reduction to the liability for unrecognized tax benefits and interest of \$0.1 million primarily related to tax years prior to 2002 as a result of the expiration of the statute of limitations for the 2002 tax year. The remainder of the decline in income tax expense reflects the decline in pre-tax income from continuing operations before income taxes from the first six months of 2008 to the first six months of 2009.

The statute of limitations for the 2003 tax year expired on July 31, 2009. As a result, our income tax provision for the third quarter of 2009 will include a reduction to the liability for unrecognized tax benefits and interest of approximately \$1.7 million related to tax years prior to 2002.

We employ various tax strategies, including strategies to minimize the amount of taxes resulting from realized capital gains.

The dividends received deduction, or DRD, reduces the amount of dividend income subject to U.S. tax and is a significant component of the difference between our effective tax rate and the federal statutory tax rate of 35%. The DRD for the current period was estimated using information from 2008, current year results, and was adjusted to take into account the current year's equity market performance. The actual current year DRD can vary from the estimate based on factors such as, but not limited to, changes in the amount of dividends received that are eligible for the DRD, changes in the amount of distributions received from mutual fund investments, changes in the account balances of variable life and annuity contracts, and our taxable income before the DRD.

In August 2007, the Internal Revenue Service, or IRS, released Revenue Ruling 2007-54, which included, among other items, guidance on the methodology to be followed in calculating the DRD related to variable life insurance and annuity contracts. In September 2007, the IRS released Revenue Ruling 2007-61. Revenue Ruling 2007-61 suspends Revenue Ruling 2007-54 and informs taxpayers that the U.S. Treasury Department and the IRS have indicated that they intend to address through new regulations the issues considered in Revenue Ruling 2007-54, including the methodology to be followed in determining the DRD related to variable life insurance and annuity contracts. On May 11, 2009, the Obama Administration released the "General Explanations of the Administration's Revenue Proposals." Although the Administration has not released proposed statutory language, one proposal would change the method used to determine the amount of the DRD. A change in the DRD, including the possible retroactive or prospective elimination of this deduction through regulation or legislation, could increase our actual tax expense and reduce our consolidated net income. These activities had no impact on our 2008 or 2009 results.

In December 2006, the IRS completed all fieldwork with respect to its examination of the consolidated federal income tax returns for tax years 2002 and 2003. The final report was initially submitted to the Joint Committee on Taxation for their review in April 2007. The final report was resubmitted in March 2008 and again in April 2008. The Joint Committee returned the report to the IRS for additional review of an industry issue regarding the methodology for calculating the DRD related to variable life insurance and annuity contracts. The IRS completed its review of the issue and proposed an adjustment with respect to the calculation of the DRD. In order to expedite receipt of an income tax refund related to the 2002 and 2003 tax years, we have agreed to such adjustment. The report, with the adjustment to the DRD, was submitted to the Joint Committee on Taxation in October 2008. We were advised on January 2, 2009 that the Joint Committee completed its consideration of the report and has taken no exception to the conclusions reached by the IRS. Accordingly, the final report was processed and a refund was received in February 2009. We believe that our return position with respect to the calculation of the DRD is technically correct. Therefore, we intend to file a protective refund claim within six months of the expiration of the respective statutes of limitations to recover the taxes associated with the agreed upon adjustment and to pursue such other actions as appropriate. These activities had no impact on our 2008 or 2009 results.

In January 2007, the IRS began an examination of tax years 2004 through 2006. For tax years 2007, 2008 and 2009, we participated in the IRS's Compliance Assurance Program, or CAP. Under CAP, the IRS assigns an examination team to review completed transactions contemporaneously during these tax years in order to reach agreement with us on how they should be reported in the tax return. If disagreements arise, accelerated resolutions programs are available to resolve the disagreements in a timely manner before the tax returns are filed. It is management's expectation that this program will shorten the time period between the filing of our federal income tax returns and the IRS's completion of its examination of the returns.

Liquidity and Capital Resources

Extraordinary Market Conditions and their Impact on our Liquidity and Capital Resources

The Company is a wholly owned subsidiary of Pruco Life Insurance Company and indirectly owned by Prudential Financial. It is possible that we may need to rely on our parent company to meet our liquidity needs in the future.

The disruptions in the capital markets that began in the latter half of 2007, initially due to concerns over sub-prime mortgage holdings of financial institutions, accelerated to unprecedented levels in 2008, resulting in failure, consolidation, or U.S. federal government intervention on behalf of several significant financial institutions. The ensuing volatility in markets, and the adverse impact on availability and cost of credit and capital, have largely continued into 2009. We, like other financial institutions, have not been immune to these events.

During the fourth quarter of 2008, the volatility and disruptions in the credit and capital markets reached unprecedented levels, adversely affecting the global economy, particularly in the financial services industry. The U.S. federal government has taken or is considering taking actions in order to address this financial market dislocation.

This market dislocation has adversely impacted our liquidity and capital plans, results of operations, and financial position. The market conditions also negatively impacted the level of capital, as a result of asset value declines and the need to strengthen reserves, particularly in our annuity businesses.

Prudential Financial and the Company continues to operate and has access to alternate sources of liquidity. However, a continuation or worsening of the disruptions in the credit and capital markets could adversely affect our ability to access sources of liquidity, as well as threaten to reduce our capital below a level that is consistent with our existing ratings objectives. Therefore, we may need to take additional actions, which may include but are not limited to: (1) further access to our alternative sources of liquidity; (2) access to external sources of capital; (3) limiting or curtailing sales of certain products and/or restructuring existing products; (4) undertaking asset sales; (5) seeking temporary or permanent changes to regulatory rules. Certain of these actions may require regulatory approval; and (6) other capital management activities.

Management monitors the liquidity of Prudential Financial and the Company on a daily basis and projects borrowing and capital needs over a multi-year time horizon through our quarterly planning process. We believe that cash flows from the sources of funds presently available to us are sufficient to satisfy the current liquidity requirements of Prudential Financial and the Company, including reasonably foreseeable contingencies.

General Liquidity

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

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

Cash Flow

The principal sources of the Company's liquidity are premiums and annuity considerations, investment and fee income, and investment maturities and sales associated with our insurance and annuity operations, as well as internal borrowings. The principal uses of that liquidity include benefits, claims, dividends paid to policyholders, and payments to policyholders and contractholders in connection with surrenders, withdrawals and net policy loan activity. Other uses of liquidity include commissions, general and administrative expenses, purchases of investments, and payments in connection with financing activities.

We believe that the cash flows from our insurance and annuity operations are adequate to satisfy the current liquidity requirements of these operations, including under reasonably foreseeable stress scenarios. The continued adequacy of this liquidity will depend upon factors such as future securities

market conditions, changes in interest rate levels, policyholder perceptions of our financial strength, and the relative safety of competing products (including those with enhancements under Emergency Economic Stabilization Act of 2008) or EESA, each of which could lead to reduced cash inflows or increased cash outflows. In addition, market volatility can impact the level of capital required to support our businesses, particularly in our annuity business. Our cash flows from investment activities result from repayments of principal, proceeds from maturities and sales of invested assets and investment income, net of amounts reinvested. The primary liquidity risks with respect to these cash flows are the risk of default by debtors or bond insurers, our counterparties' willingness to extend repurchase and/or securities lending arrangements, commitments to invest and market volatility. We closely manage these risks through our credit risk management process and regular monitoring of our liquidity position.

In managing our liquidity, we also consider the risk of policyholder and contractholder withdrawals of funds earlier than our assumptions when selecting assets to support these contractual obligations. We use surrender charges and other contract provisions to mitigate the extent, timing and profitability impact of withdrawals of funds by customers from annuity contracts and deposit liabilities.

Individual life insurance policies are less susceptible to withdrawal than our annuity reserves and deposit liabilities because policyholders may incur surrender charges and be subject to a new underwriting process in order to obtain a new insurance policy. Our annuity reserves with guarantee features may be less susceptible to withdrawal than historical experience indicates, due to the current value of these guarantee features to policyholders as a result of recent market declines.

Gross account withdrawals amounted to approximately \$60 million and \$64 million for the six months ended June 30, 2009 and 2008, respectively. Because these withdrawals were consistent with our assumptions in asset/liability management, the associated cash outflows did not have a material adverse impact on our overall liquidity.

Liquid Assets

Liquid assets include cash, cash equivalents, short-term investments, fixed maturities and public equity securities. As of June 30, 2009 and December 31, 2008, our insurance operations had liquid assets of \$1.025 million and \$876.8 million, respectively. The portion of liquid assets comprised of cash and cash equivalents and short-term investments was \$72 million and \$78 million as of June 30, 2009 and December 31, 2008, respectively. As of June 30, 2009, \$836 million, or 88%, of the fixed maturity investments company general account portfolios were rated investment grade. The remaining \$115 million, or 12%, of these fixed maturity investments were rated non-investment grade. We consider attributes of the various categories of liquid assets (for example, type of asset and credit quality) in calculating internal liquidity measures in order to evaluate the adequacy of our liquidity under a variety of stress scenarios. We believe that the liquidity profile of our assets is sufficient to satisfy current liquidity requirements, including under foreseeable stress scenarios.

Given the size and liquidity profile of our investment portfolios, we believe that claim experience varying from our projections does not constitute a significant liquidity risk. Our asset/liability management process takes into account the expected maturity of investments and expected claim payments as well as the specific nature and risk profile of the liabilities. Historically, there has been no significant variation between the expected maturities of our investments and the payment of claims.

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

Prudential Funding, LLC

Prudential Funding, LLC, or Prudential Funding, a wholly owned subsidiary of Prudential Insurance, serves as an additional source of financing to meet the working capital needs.

Capital

The Risk Based Capital, or RBC, ratio is a primary measure by which we evaluate the capital adequacy of the Company. We manage our RBC ratio to a level consistent with a "AA" ratings objective. RBC is determined by statutory formulas that consider risks related to the type and quality of the invested assets, insurance-related risks associated with an insurer's products, interest rate risks and general business risks. The RBC ratio calculations are intended to assist insurance regulators in measuring the adequacy of an insurer's statutory capitalization.

As discussed above, market conditions during 2008 negatively impacted the level of our capital. In order to address these impacts on our capital, Prudential Financial undertook various initiatives to redeploy certain assets to its insurance subsidiaries from its non-insurance subsidiaries.

The level of statutory capital of the Company can be materially impacted by interest rate and equity market fluctuations, changes in the values of derivatives, the level of impairments recorded, and credit quality migration, among other items. The level of statutory capital of the Company is affected by statutory accounting rules, including those for loan-backed and structured securities. Mandatory adoption of changes to the rules for loan-backed and structured securities was recently deferred until periods ending on or after September 30, 2009. Further changes to these rules by insurance regulators, or the timing of the Company's application of these rules, are possible, given the deferral and other uncertainty around the resolution of these accounting rules.

The implementation of VACARVM, a new statutory reserve methodology for variable annuities with guaranteed benefits, effective December 31, 2009 is not expected to have a material impact on the statutory surplus of the Company. However, VACARVM is expected to result in higher statutory reserves ceded to our offshore captive reinsurance company, which we currently anticipate will increase statutory reserve credit requirements by approximately \$20 million from December 31, 2008. Several strategies are currently under review to meet the increased statutory reserve credit requirement. The activities we may undertake to mitigate or address these needs include obtaining letters of credit, executing capital market strategies, or holding assets equal to the statutory reserve credit in a trust. However, our ability to successfully execute these strategies may depend on market or other conditions.

Item 3. Controls and Procedures

In order to ensure that the information we must disclose in our filings with the Securities and Exchange Commission, or "SEC," is recorded, processed, summarized, and reported on a timely basis, the Company's management, including our Chief Executive Officer and Chief Financial Officer, have reviewed and evaluated the effectiveness of our disclosure controls and procedures, as defined in Exchange Act Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, as of June 30, 2009. Based on such evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of June 30, 2009, our disclosure controls and procedures were effective. No change in the Company's internal control over financial reporting, as defined in Exchange Act Rule 13a-15(f) and 15d-15(f), occurred during the quarter ended June 30, 2009 that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

The Company is subject to legal and regulatory actions in the ordinary course of its businesses, including class action lawsuits. Legal and regulatory actions may include proceedings relating to aspects of the businesses and operations that are specific to the Company and that are typical of the businesses in which the Company operates. Class action and individual lawsuits may involve a variety of issues and/or allegations, which include sales practices, underwriting practices, claims payment and procedures, premium charges, and policy servicing. The Company may also be subject to litigation arising out of its general business activities, such as its investments and third party contracts. In certain of these matters, plaintiffs may seek large and/or indeterminate amounts, including punitive or exemplary damages.

The Company's litigation and regulatory matters are subject to many uncertainties, and given their complexity and scope, their outcomes cannot be predicted. It is possible that results of operations or cash flow of the Company in a particular quarterly or annual period could be materially affected by an ultimate unfavorable resolution of pending litigation and regulatory matters depending, in part, upon the results of operations or cash flow for such period. In light of the unpredictability of the Company's litigation and regulatory matters, it is also possible that in certain cases an ultimate unfavorable resolution of one or more pending litigation or regulatory matters could have a material adverse effect on the Company's financial position. Management believes, however, that, based on information currently known to it, the ultimate outcome of all pending litigation and regulatory matters, after consideration of applicable reserves and rights to indemnification, is not likely to have a material adverse effect on the Company's financial position.

The foregoing discussion is limited to recent developments concerning our legal and regulatory proceedings. See Note 2 to the Unaudited Interim Financial Statements included herein for additional discussion of our litigation and regulatory matters.

Item 1A. Risk Factors

You should carefully consider the following risks. These risks could materially affect our business, results of operations or financial condition or cause our actual results to differ materially from those expected or those expressed in any forward looking statements made by or on behalf of the Company. These risks are not exclusive, and additional risks to which we are subject include, but are not limited to, the factors mentioned under "Forward-Looking Statements" above and the risks of our businesses described elsewhere in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the year ended, December 31, 2008.

The Company is a wholly owned subsidiary of Pruco Life Insurance Company and indirectly owned by Prudential Financial. It is possible that we may need to rely on our parent company to meet our liquidity needs in the future.

Our business and our results of operations have been materially adversely affected by the adverse conditions in the global financial markets and economic conditions generally. Our business, results of operations and financial condition may be further adversely affected, possibly materially, if these conditions persist or deteriorate.

Our results of operations have been materially adversely affected by conditions in the global financial markets and the economy generally, both in the U.S. and elsewhere around the world. The global financial markets have experienced extreme stress since the second half of 2007. Volatility and disruption in the global financial markets reached unprecedented levels in the post World War II period. The availability and cost of credit has been materially affected. These factors, combined with economic conditions in the U.S. including depressed home and commercial real estate prices and increasing foreclosures, falling equity market values, declining business and consumer confidence and rising unemployment, have precipitated a severe economic recession and fears of even more severe and prolonged adverse economic conditions.

Due to the economic environment, the global fixed-income markets have experienced both extreme volatility and limited market liquidity conditions, which has affected a broad range of asset classes and sectors. As a result, the market for fixed income instruments has experienced decreased liquidity, increased price volatility, credit downgrade events, and increased probability of default. Global equity markets have also been experiencing heightened volatility. These events have had and may continue to have an adverse effect on us. Our revenues are likely to decline in such circumstances, the cost of meeting our obligations to our customers may increase, and our profit margins would likely erode. In addition, in the event of a prolonged or severe economic downturn, we could incur significant losses in our investment portfolio.

The demand for our products could be adversely affected in an economic downturn characterized by higher unemployment, lower family income, lower consumer spending, lower corporate earnings and lower business investment. We also may experience a higher incidence of claims and lapses or surrenders of policies. Our policyholders may choose to defer or stop paying insurance premiums. We cannot predict definitively whether or when such actions, which could impact our business, results of operations, cash flows and financial condition, may occur.

Markets in the United States and elsewhere have experienced extreme and unprecedented volatility and disruption, with adverse consequences to our liquidity, access to capital and cost of capital. Market conditions such as we have experienced since the second half of 2007 may significantly affect our ability to meet liquidity needs, our access to capital and our cost of capital, including capital that may be required by our subsidiaries.

Adverse capital market conditions have affected and may continue to affect the availability and cost of borrowed funds and could impact our ability to refinance existing borrowings, thereby ultimately impacting our profitability and ability to support or grow our businesses. We need liquidity to pay our operating expenses, interest on our debt and dividends on our capital stock and replace certain maturing debt obligations. Without sufficient liquidity, we could be forced to curtail certain of our operations, and our business could suffer. The principal sources of our liquidity are insurance premiums, annuity considerations, deposit funds and cash flow from our investment portfolio and assets, consisting mainly of cash or assets that are readily convertible into cash. Sources of liquidity in normal markets also include a variety of short- and long-term instruments, including securities lending and repurchase agreements, and commercial paper.

Disruptions, uncertainty or volatility in the financial markets have limited and may be expected to continue to limit our access to capital required to operate our business, most significantly our insurance operations. These market conditions may limit our ability to replace, in a timely manner, maturing debt obligations and access the capital necessary to grow our business, replace capital withdrawn by customers or raise new capital required as a result of volatility in the markets. As a result, we may be forced to delay raising capital, issue shorter tenor securities than would be optimal, bear an unattractive cost of capital or be unable to raise capital at any price, which could decrease our profitability and significantly reduce our financial flexibility. Actions we might take to access financing may in turn cause rating agencies to reevaluate our ratings.

We may seek additional financing. The availability of additional financing will depend on a variety of factors such as market conditions, the general availability of credit, the overall availability of credit to the financial services industry, and our credit ratings and credit capacity. We may not be able to successfully obtain additional financing on favorable terms, or at all.

The Risk Based Capital, or RBC, ratio is the primary measure by which we evaluate our capital adequacy. We manage our RBC ratio to a level consistent with a “AA” ratings objective; however, rating agencies take into account a variety of factors in assigning ratings in addition to RBC levels. RBC is determined by statutory rules that consider risks related to the type and quality of the invested assets, insurance-related risks associated with our products, interest rate risks and general business risks. The RBC ratio calculations are intended to assist insurance regulators in measuring the adequacy of our statutory capitalization. Subsequent to September 30, 2008 market conditions negatively impacted our level of capital and caused Prudential Financial to take capital management actions to maintain capital consistent with these ratings objectives, which included redeployment of financial resources from internal sources. The RBC ratio is an annual calculation; however, based upon June 30, 2009 amounts, the RBC for Prudential Insurance and our other domestic life insurance subsidiaries would exceed the minimum level required by applicable insurance regulations. The level of statutory capital of our domestic life insurance subsidiaries is affected by the statutory account rules for loan-backed and structured securities. Mandatory adoption of changes to these rules was recently deferred until periods ending on or after September 30, 2009. Further changes to these rules by insurance regulators, or the timing of the Company’s application of these rules, are possible, given the deferral and other uncertainty around the resolution of these accounting rules.

Disruptions in the capital markets could adversely affect our ability to access sources of liquidity, as well as threaten to reduce our capital below a level that is consistent with our existing ratings objectives. Therefore, we may need to take additional actions, which may include but are not limited to: (1) additional capital management activities; (2) accelerating or restructuring loans extended to affiliates; (3) further access to external sources of capital; (4) limiting or curtailing sales of certain products and/or restructuring existing products; (5) undertaking asset sales or internal asset transfers; and (6) seeking temporary or permanent changes to regulatory rules. Certain of these actions could require regulatory approval or have economic costs associated with them.

Governmental actions in response to the current financial crisis may not be effective and could subject us to additional regulation. Participation by us in certain of these governmental programs could also result in limitations or restrictions on our businesses or otherwise restrict our flexibility.

In response to the market dislocation affecting the banking system and financial markets, on October 3, 2008, President Bush signed the Emergency Economic Stabilization Act of 2008, or EESA, into law. Pursuant to the EESA, the U.S. Treasury has the authority to, among other things, purchase up to \$700 billion of mortgage-backed and other securities from financial institutions for the purpose of stabilizing the financial markets. On October 14, 2008, the U.S. Treasury announced that it would use EESA authority to invest an aggregate of \$250 billion (of the first \$350 billion released under EESA) in capital issued by qualifying U.S. financial institutions under the U.S. Treasury’s Capital Purchase Program, which is part of the Troubled Asset Relief Program, or TARP. The TARP Capital Purchase Program involves the issuance by qualifying institutions of preferred stock and warrants to purchase common stock to the U.S. Treasury. On June 1, 2009, we announced that, after conducting a thorough review, we would not participate in the TARP Capital Purchase Program. Concurrently, with the announcement of the TARP Capital Purchase Program in coordination with the U.S. Treasury, the Federal Deposit Insurance Corporation, or FDIC announced the Temporary Liquidity Guarantee Program, through which it guarantees certain newly issued senior unsecured debt issued by FDIC insured institutions and their qualifying holding companies, as well as funds over \$250,000 in non-interest-bearing transaction deposit accounts. In addition, since March 2008, the Federal Reserve has created several lending facilities to stabilize financial markets including the Term Asset-Backed Securities Loan Facility, or TALF. The TALF is designed to provide secured financing for certain types of asset-backed securities, including (as of July 2009) certain high-quality commercial mortgage-backed securities issued before January 1, 2009.

On February 10, 2009, the U.S. Treasury announced a Financial Stability Plan to build upon existing programs and earmark the second \$350 billion of funds that were authorized under the EESA and released in January 2009. The elements of the Financial Stability Plan, as described by the U.S. Treasury, are a Capital Assistance Program and Financial Stability Trust to make capital available to financial institutions through additional purchases of preferred stock, a Public-Private Investment Program, or PPIP, to buy legacy loans and assets from financial institutions, a Consumer and Business Lending Initiative to restart securitization markets for loans to consumers and businesses by expanding upon TALF, and a comprehensive housing program to, among other things, help reduce mortgage payments and interest rates. The U.S. Treasury has stated that the Financial Stability Plan will require high levels of transparency and accountability standards and dividend, acquisition and executive compensation restrictions for financial institutions that receive government assistance going forward.

In the first and second quarter of 2009, the U.S. Treasury, in conjunction with the FDIC and the Federal Reserve, announced details regarding the PPIP. The PPIP has two separate parts to address the problem of “legacy assets” — real estate loans held directly on the books of banks (“legacy loans”) and securities backed by loan portfolios (“legacy securities”). Under the Legacy Loans Program portion of the PPIP, the U.S. Treasury will invest alongside private investors in individual investment funds referred to as Public-Private Investment Funds, which will purchase eligible asset pools from depository institutions and the FDIC on a discrete basis. The FDIC will provide a guarantee for the debt financing issued by the Public-Private Investment Funds to fund the asset purchases. The FDIC has stated that it plans to test the funding mechanism contemplated by the Legacy Loan Program during the summer of 2009, but an official commencement date for the program has not been announced. Under the Legacy Securities Program, the U.S. Treasury will co-invest with, and provide leverage to, pre-approved asset managers to support the market for certain legacy securities. Legacy securities eligible for the program include commercial mortgage backed and residential mortgage backed securities originated prior to 2009 with a rating of AAA at the time of origination.

Our ultimate parent, Prudential Financial applied in October 2008 to participate in the TARP Capital Purchase Program, and in May 2009 received preliminary approval from the U.S. Treasury to participate in the Program. However, on June 1, 2009 the Company announced that it would not participate in the Capital Purchase Program.

In the second half of 2009, Prudential Financial participated in TALF as an eligible borrower. As of June 30, 2009, Prudential Financial had \$1,250 million of securities purchased under TALF that are reflected within "Other trading account assets" and received secured financing from the Federal Reserve of \$1,167 million related to the purchase of these securities that is reflected within "long-term debt." Prudential Financial also continue to evaluate participation in other government sponsored programs for which we may be eligible.

The U.S. federal government has taken or is considering taking other actions to address the financial crisis, including mortgage and credit card program modification proposals that could further impact our business. We cannot predict with any certainty whether these actions will be effective or the effect they may have on the financial markets or on our business, results of operations, cash flows and financial condition.

On June 17, 2009, the Obama Administration announced proposals to reform the national regulation of various financial institutions. Depending on the manner of adoption of these or other proposals, we could become subject to increased federal regulation, either as a bank holding company or a "Tier 1 financial holding company". Such regulation could involve higher capital requirements, limits on business activities, limits on leverage and other regulatory supervision, including by the Board of Governors of the Federal Reserve System. We cannot predict the form in which such proposals will be adopted (if at all) or their applicability to or effect on our business, financial condition or results of operations.

Market fluctuations and general economic, market and political conditions may adversely affect our business and profitability.

Even under relatively more favorable market conditions (such as those prevailing before the second half of 2007), our insurance products and certain of our investment products, as well as our investment returns and our access to and cost of financing, are sensitive to fixed income, equity, real estate and other market fluctuations and general economic, market and political conditions. These fluctuations and conditions could adversely affect our results of operations, financial position and liquidity, including in the following respects:

- The profitability of many of our insurance products depends in part on the value of the separate accounts supporting these products, which fluctuate substantially depending on the foregoing conditions.
- Market conditions resulting in reductions in the value of assets we administer have an adverse effect on the revenues and profitability of our asset administration services, which depend on fees, related primarily to the value of assets under management, and could further decrease the value of our proprietary investments.
- A change in market conditions, including prolonged periods of high inflation, could cause a change in consumer sentiment adversely affecting sales and persistency of our products. Similarly, changing economic conditions and unfavorable public perception of financial institutions can influence customer behavior including but not limited to increasing claims in certain annuities.
- Sales of our investment-based and asset management products and services may decline and lapses and surrenders of variable life and annuity products and withdrawals of assets from other 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.
- A market decline could further result in guaranteed minimum benefits contained in many of our variable annuity products being higher than current account values or our pricing assumptions would support, requiring us to materially increase reserves for such products and may cause customers to retain contracts in force in order to benefit from the guarantees, thereby increasing their cost to us. 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 on non-performance; and a decrease in our own credit spreads resulting from rating 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.
- Market conditions determine the availability and cost of the reinsurance protection we purchase including through our affiliates. Accordingly, we may be forced to incur additional expenses for reinsurance or may not be able to obtain sufficient reinsurance on acceptable terms which could adversely affect the profitability of future business or our willingness to write future business.

- Hedging instruments held by the Company and affiliated reinsurers to manage product and other risks might not perform as intended or expected resulting in higher realized losses and unforeseen cash needs. Market conditions can also 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. Our hedging strategies rely on the performance of counterparties to such hedges. These counterparties may fail to perform for various reasons resulting in hedge ineffectiveness and higher losses.
- We have significant investment and derivative portfolios, including but not limited to corporate and asset-backed securities, equities and commercial real estate. Economic conditions as well as adverse capital market conditions, including but not limited to a lack of buyers in the marketplace, volatility, credit spread changes, benchmark interest rate changes, and declines in value of underlying collateral will impact the credit quality, liquidity and value of our investments and derivatives, potentially resulting in higher capital charges and unrealized or realized losses, the latter especially if we were to need to sell a significant amount of investments under such conditions. For example, a widening of credit spreads, increases the net unrealized loss position of our investment portfolio and may ultimately result in increased realized losses. Values of our investments and derivatives can also be impacted by reductions in price transparency, changes in assumptions or inputs we use in estimating fair value and changes in investor confidence and preferences, potentially resulting in higher realized or unrealized losses. Volatility can make it difficult to value certain of our securities if trading becomes less frequent. As such, valuations may include assumptions or estimates that may have significant period to period changes which could have a material adverse effect on our results of operations or financial condition and in certain cases under U.S. GAAP such period to period changes in the value of investments are not recognized in our results of operations or consolidated statements of financial condition.
- Regardless of market conditions, certain investments we hold, including private bonds and commercial mortgages are relatively illiquid. If we needed to sell these investments, we may have difficulty doing so in a timely manner at a price that we could otherwise realize.

As described above, the period since the second half of 2007 has been characterized by extreme adverse market and economic conditions. The foregoing risks are even more pronounced in these unprecedented market and economic conditions.

Interest rate fluctuations could adversely affect our businesses and profitability.

Our insurance products and certain of our investment products, and our investment returns, are sensitive to interest rate fluctuations, and changes in interest rates could adversely affect our investment returns and results of operations, including in the following respects:

- 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 the contracts and the rate of return we are able to earn on our general account investments supporting the contracts. When interest rates decline, we have to reinvest the cash income from our investments in lower yielding instruments. Since many of our policies and contracts have guaranteed minimum interest or crediting rates or limit the resetting of interest rates, the spreads could decrease and potentially become negative. When interest rates rise, we may not be able to replace the assets in our general account with the higher yielding assets needed to fund the higher crediting rates necessary to keep these products and contracts competitive. This risk is heightened in the current market and economic environment, in which many desired securities are unavailable. Some of our universal life products contain other death benefits guarantees, the cost of which depend on our investment return.
- Changes in interest rates may reduce net investment income and thus our spread income which is a substantial portion of our profitability. A decline in market interest rates could also reduce our returns from investment of equity.
- When interest rates rise, policy loans and surrenders and withdrawals of life insurance policies and annuity contracts may increase as policyholders seek to buy products with perceived higher returns, requiring us to sell investment assets potentially resulting in realized investment losses, or requiring us to accelerate the amortization of DAC (defined below).

- A decline in interest rates accompanied by unexpected prepayments of certain investments could result in reduced investment and a decline in our profitability. An increase in interest rates accompanied by unexpected extensions of certain lower yielding investments could result in a decline in our profitability.
- Changes in the relationship between long-term and short-term interest rates could adversely affect the profitability of some of our products.
- Changes in interest rates could increase our costs of financing.
- Our mitigation efforts with respect to interest rate risk are primarily focused on maintaining an investment portfolio with diversified maturities that has a weighted average duration that is approximately equal to the duration of our estimated liability cash flow profile. However, there are practical and capital market limitations on our ability to accomplish this and our estimate of the liability cash flow profile may be inaccurate. 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. Although we take measures to manage the economic risks of investing in a changing interest rate environment, we may not be able to effectively mitigate, and may choose based on factors, including economic considerations, not to fully mitigate, the interest rate risk of our assets relative to our liabilities.

If our reserves for future policyholder benefits and claims are inadequate, we may be required to increase our reserves, which would adversely affect our results of operations and financial condition.

We establish and carry reserves to pay future policyholder benefits and claims. Our reserves do not represent an exact calculation of liability, but rather are actuarial or statistical estimates based on models that include many assumptions and projections which are inherently uncertain and involve the exercise of significant judgment, including as to the levels of and/or timing of receipt or payment of premiums, benefits, claims, expenses, interest credits, investment results (including equity market returns), retirement, mortality, morbidity and persistency. We cannot determine with precision the ultimate amounts that we will pay for, or the timing of payment of, actual benefits, claims and expenses or whether the assets supporting our policy liabilities, together with future premiums will be sufficient for payment of benefits and claims. If we conclude that our reserves, together with future premiums, are insufficient to cover future policy benefits and claims, we would be required to increase our reserves and incur income statement charges for the period in which we make the determination, which would adversely affect our results of operations and financial condition.

For certain of our products, market performance and interest rates impact the level of statutory reserves and statutory capital we are required to hold, and may have an adverse effect on returns on capital associated with these products. For example, equity market declines in the fourth quarter of 2008 caused a significant increase in the level of statutory reserves and statutory capital we are required to hold in relation to our Individual Annuities business. Capacity for reserve funding structures available in the marketplace is currently limited as a result of market conditions generally. Our ability to efficiently manage capital and economic reserve levels may be impacted, thereby impacting profitability and return on capital.

Our profitability may decline if mortality rates, morbidity rates or persistency rates differ significantly from our pricing expectations.

We set prices for many of our insurance and annuity products based upon expected claims and payment patterns, using assumptions for mortality rates, or likelihood of death, and morbidity rates, or likelihood of sickness, of our policyholders. In addition to the potential effect of natural or man-made disasters, significant changes in mortality or morbidity could emerge gradually over time, due to changes in the natural environment, the health habits of the insured population, treatment patterns for disease or disability, the economic environment, or other factors. Pricing of our insurance and deferred annuity products are also based in part upon expected persistency of these products, which is the probability that a policy or contract will remain in force from one period to the next. Persistency within our Individual 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 equity market declines. Results may also vary based on differences between actual and expected premium deposits and withdrawals for these products. The development of a secondary market for life insurance, including life settlements or “viaticals” and investor owned life insurance, could adversely affect the profitability of existing business and our pricing assumptions for new business. Significant deviations in actual experience from our pricing assumptions could have an adverse effect on the profitability of our products. 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. 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.

We may be required to accelerate the amortization of deferred policy acquisition costs, or DAC, or recognize impairment in the value of certain investments, or be required to establish a valuation allowance against deferred income tax assets, any of which could adversely affect our results of operations and financial condition.

Deferred policy acquisition costs, or DAC, represent the costs that vary with and are related primarily to the acquisition of new and renewal insurance and annuity contracts, and we amortize these costs over the expected lives of the contracts. Management, on an ongoing basis, tests DAC recorded on our balance sheet to determine if these amounts are recoverable under current assumptions. In addition, we regularly review the estimates and assumptions underlying DAC for those products for which we amortize DAC in proportion to gross profits. Given changes in facts and circumstances, these tests and reviews could lead to further reductions in DAC that could have an adverse effect on the results of our operations and our financial condition. Significant or sustained equity market declines as well as investment losses has resulted and could result in further acceleration of amortization of the DAC related to variable annuity and variable universal life contracts, resulting in a charge to income.

Deferred income tax represents the tax effect of the differences between the book and tax basis of assets and liabilities. Deferred tax assets are assessed periodically by management to determine if they are realizable. Factors in management's determination include the performance of the business including the ability to generate capital gains from a variety of sources and tax planning strategies. If based on available information, it is more likely than not that the deferred income tax asset will not be realized then a valuation allowance must be established with a corresponding charge to net income. Such charges could have a material adverse effect on our results of operations or financial position.

Our valuation of fixed maturity, equity and trading securities may include methodologies, estimations and assumptions that are subject to differing interpretations and could result in changes to investment valuations that may materially adversely affect our results of operations or financial condition.

During periods of market disruption, such as the unprecedented current market conditions, it may be difficult to value certain of our securities, such as sub-prime mortgage backed securities, if trading becomes less frequent and/or market data becomes less observable. There are and may continue to be certain asset classes that were in active markets with significant observable data that become illiquid due to the current financial environment or market conditions. As a result, valuations may include inputs and assumptions that are less observable or require greater estimation and judgment as well as valuation methods which are more complex. These values may not be ultimately realizable in a market transaction, and such values may change very rapidly as market conditions change and valuation assumptions are modified. Decreases in value may have a material adverse effect on our results of operations or financial condition.

The decision on whether to record an other-than-temporary impairment or write-down is determined in part by management's assessment of the financial condition and prospects of a particular issuer, projections of future cash flows and recoverability of the particular security. Management's conclusions on such assessments are highly judgmental and include assumptions and projections of future cash flows which may ultimately prove to be incorrect as assumption, facts and circumstances change.

For a discussion of certain fixed maturity securities where the estimated fair value has declined and remained below amortized cost by more than 20%, respectively, see "Realized Investment Gains and Losses and General Account Investments – Unrealized Losses from Fixed Maturity Securities."

We have experienced and may experience additional downgrades in our claims-paying or credit ratings. A downgrade or potential downgrade in our claims-paying or credit ratings could limit our ability to market products, increase the number or value of policies being surrendered, increase our borrowing costs and/or hurt our relationships with creditors or trading counterparties.

Claims-paying ratings, which are sometimes referred to as "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, and are important factors affecting public confidence in an insurer and its competitive position in marketing products. Credit ratings represent the opinions of rating agencies regarding an entity's ability to repay its indebtedness. A downgrade in our claims-paying or credit ratings 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 under certain agreements, allow counter parties to terminate derivative agreements, and/or hurt our relationships with creditors or trading counterparties.

In view of the difficulties experienced recently by many financial institutions, the rating agencies have heightened the level of scrutiny that they apply to such institutions, have increased the frequency and scope of their credit reviews, have requested additional information from the companies that they rate, and may adjust upward the capital and other requirements employed in the rating agency models for maintenance of certain ratings levels, such as our financial strength ratings. The outcome of such reviews may have adverse ratings consequences, which could have a material adverse effect on our results of operation and financial condition.

In late September and early October, 2008, A.M. Best Company, Inc., Fitch Ratings Ltd., Moody's Investors Service, and Standard & Poor's, respectively, each revised its outlook for the U.S. life insurance sector to negative from stable, citing, among other things, the significant deterioration and volatility in the credit and equity markets, economic and political uncertainty, and the expected impact of realized and unrealized investment losses on life insurers' capital levels and profitability.

On November 21, 2008, Moody's affirmed the long-term senior debt rating of Prudential Financial at "A3" and affirmed the financial strength ratings of our life insurance subsidiaries at "Aa3." Moody's also revised its outlook on our ratings to negative from stable. On February 10, 2009 Moody's

placed the long-term ratings of Prudential Financial and our life insurance subsidiaries on review for possible downgrade. The short-term ratings of Prudential Financial and Prudential Funding were affirmed with a stable outlook. On March 18, 2009, Moody's lowered the long-term senior debt rating of Prudential Financial to "Baa2" from "A2" and lowered the financial strength ratings of Prudential Financial's [domestic] life insurance subsidiaries to "A2" from "Aa3." The outlook for the ratings remains negative. In addition, Moody's placed the short-term debt rating of Prudential Funding, LLC on review for possible downgrade.

On December 2, 2008, Fitch lowered Prudential Financial's long-term senior debt rating to "A-" from "A" and lowered the financial strength ratings of our life insurance subsidiaries to "AA-" from "AA," with ratings outlook revised from stable to negative. On February 19, 2009, Fitch lowered Prudential Financial's long-term senior debt rating to "BBB" from "A-" and the short-term rating to "F2" from "F1." Fitch also downgraded the financial strength ratings of our life insurance subsidiaries to "A+" from "AA-" and the short-term rating of Prudential Funding, LLC to "F1" from "F1+." The outlook for all ratings remains negative.

On December 11, 2008, A.M. Best affirmed the financial strength rating of "A+" for our life insurance subsidiaries and affirmed the credit rating of "a-" for Prudential Financial's long-term senior debt. The outlook for the financial strength ratings remained stable and the outlook for the long-term senior debt credit rating was revised to stable from positive.

On February 17, 2009, S&P lowered Prudential Financial's long-term senior debt rating to "A" from "A+" and affirmed the "AA" ratings of our life insurance subsidiaries. The long-term ratings outlook was revised from stable to negative.

On February 26, 2009, S&P lowered the financial strength ratings of our life insurance subsidiaries to "AA-" from "AA" and affirmed Prudential Financial's long-term senior debt ratings as "A." The outlook for both ratings was revised from negative to stable.

Both Prudential Financial's and Prudential Funding's commercial paper programs were granted approval to participate in the Federal Reserve's Commercial Paper Funding Facility, or CPFF, during the fourth quarter of 2008. Commercial paper issuers must maintain ratings of at least A-1/P-1/F-1 by two rating agencies in order to be eligible for CPFF. On February 19, 2009, Prudential Financial's commercial paper rating was downgraded by Fitch from F1 to F2 and, consequently, as of that date, Prudential Financial was no longer eligible to issue commercial paper under the CPFF. As of the date of this filing, Prudential Funding's commercial paper is rated A-1+/P-1/F1; however, as noted above, on March 18, 2009, Moody's placed Prudential Funding's commercial paper rating on review for possible downgrade and the Fitch rating has a negative outlook. If Prudential Funding fails to maintain the required A-1/P-1/F1 ratings by at least two rating agencies, its program would no longer be eligible for CPFF, and we would lose our access to CPFF completely.

Prudential Insurance has been a member of the Federal Home Loan Bank of New York, or FHLB NY since June 2008. Membership allows Prudential Insurance to participate in FHLB NY's product line of financial services, including collateralized advances, collateralized funding agreements, and general asset/liability management that can be used for liquidity management and as an alternative source of funding. Under FHLB NY guidelines, if Prudential Insurance's claims-paying ratings decline below certain levels, and the FHLB NY does not receive written assurance from the New Jersey Department of Banking and Insurance regarding Prudential Insurance's solvency, new borrowings from the FHLB NY would be limited to a term of 90 days or less. Although Prudential Insurance's ratings are currently at or above the required minimum levels, there can be no assurance the ratings will remain at these levels in the future.

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. As with other companies in the financial services industry, our ratings could be downgraded at any time and without notice by any rating agency.

We may be unable to effectively implement certain capital management activities as a result of ratings downgrades, and changes in credit spreads, or for other reasons.

The NAIC has adopted a Model Regulation entitled "Valuation of Life Insurance Policies," commonly known as "Regulation XXX," and a supporting Guideline entitled "The Application of the Valuation of Life Insurance Policies," commonly known as "Guideline AXXX." The Regulation and supporting Guideline require insurers to establish statutory reserves for term and universal life insurance policies with long-term premium guarantees that are consistent with the statutory reserves required for other individual life insurance policies with similar guarantees. Many market participants believe that this level of reserves is excessive, and we have implemented reinsurance and capital management actions to mitigate the impact of Regulation XXX and Guideline AXXX on our term and universal life insurance business with affiliates. However, we may not be able to implement actions to mitigate the impact of Regulation XXX or Guideline AXXX on our term or universal life insurance products, thereby potentially resulting in an adverse impact on returns on capital associated with these products, and possibly requiring us to reduce our sales of these products or implement measures that may be disruptive to our business. As we continue to underwrite term and universal life business, we expect to have borrowing needs in 2009 to finance statutory reserves required under Regulation XXX and Guideline AXXX. Several strategies are currently under review to reduce the strain of increased AXXX and XXX statutory reserves associated with our term and universal life products. The activities we may undertake to mitigate or address these needs include obtaining letters of credit, entering into reinsurance transactions or executing other capital market strategies;

however, our ability to successfully execute these strategies may depend on market conditions. Further, we have \$300 million currently available under our XXX notes facility. Absent any successful mitigation efforts and assuming full usage of the XXX notes facility, we currently believe that our financing need for 2009 could be up to \$200 million for XXX and AXXX combined, but this amount may fluctuate due to changes in market conditions or product sales. If we are unsuccessful in satisfying or mitigating this strain as a result of market conditions or otherwise, this financing need could have an adverse effect on our overall liquidity and capital and could require us to increase prices and/or reduce our sales of term or universal life products.

Losses due to defaults by others, including issuers of investment securities or reinsurance, bond insurers and derivative instrument counterparties, downgrades in the ratings of securities we hold or of bond insurers, insolvencies of insurers in jurisdictions where we write business, and other factors affecting our counterparties or the value of their securities could adversely affect the value of our investments, the realization of amounts contractually owed to us, result in assessments or additional statutory capital requirements or reduce our profitability or sources of liquidity.

Issuers and borrowers whose securities or loans we hold, customers, trading counterparties, counterparties under swaps and other derivative contracts, reinsurers, clearing agents, exchanges, clearing houses and other financial intermediaries and guarantors, including bond insurers, may default on their obligations to us due to bankruptcy, insolvency, lack of liquidity, adverse economic conditions, operational failure, fraud or other reasons. Such defaults, instances of which have occurred in recent months, could have an adverse effect on our results of operations and financial condition. A downgrade in the ratings of bond insurers could also result in declines in the value of our fixed maturity investments supported by guarantees from bond insurers.

In addition, we use derivative instruments to hedge various risks, including certain guaranteed minimum benefits contained in many of our variable annuity products. We enter into a variety of derivative instruments, including options, forwards, interest rate, default and currency swaps with a number of counterparties. Our obligations under our variable annuity products are not changed by our hedging activities and we are liable for our obligations even if our derivative counterparties do not pay us. This is a more pronounced risk to us in view of the recent stresses suffered by financial institutions. Such defaults could have a material adverse effect on our financial condition and results of operations.

Under state insurance guaranty association laws, we are subject to assessments based on the share of business we write in the relevant jurisdiction for certain obligations of insolvent insurance companies to policyholders and claimants.

Amounts that we expect to collect under current and future contracts are subject to counterparty risk.

Intense competition, including the impact of government sponsored programs and other actions on us and our competitors, could adversely affect our ability to maintain or increase our market share or profitability.

In each of our businesses we face intense competition, both for the ultimate customers for our products and, in many businesses, for distribution through non-affiliated distribution channels. We compete based on a number of factors including brand recognition, reputation, quality of service, quality of investment advice, investment performance of our products, product features, scope of distribution and distribution arrangements, price, perceived financial strength and claims-paying and credit ratings. A decline in our competitive position as to one or more of these factors could adversely affect our profitability and assets under management. Many of our competitors are large and well established and some have greater market share or breadth of distribution, offer a broader range of products, services or features, assume a greater level of risk, have lower profitability expectations or have higher claims-paying or credit ratings than we do. We could be subject to claims by competitors that our products infringe their patents, which could adversely affect our sales, profitability and financial position. The proliferation and growth of non-affiliated distribution channels puts pressure on our captive sales channels to increase their productivity and reduce their costs in order to remain competitive, and we run the risk that the marketplace will make a more significant or rapid shift to non-affiliated or direct distribution alternatives than we anticipate or are able to achieve ourselves, potentially adversely affecting our market share and results of operations. Competition for personnel in all of our business is intense. The loss of personnel could have an adverse effect on our business and profitability.

Changes in U.S. federal income tax law or in the income tax laws of other jurisdictions in which we operate could make some of our products less attractive to consumers and increase our tax costs.

Current U.S. federal income tax laws generally permit certain holders to defer taxation on the build-up of value of annuities and life insurance products until payments are actually made to the policyholder or other beneficiary and to exclude from taxation the death benefit paid under a life insurance contract. Congress from time to time considers legislation that could make our products less attractive to consumers, including legislation that would reduce or eliminate the benefit of this deferral on some annuities and insurance products, as well as other types of changes that could reduce or eliminate the attractiveness of annuities and life insurance products to consumers, such as repeal of the estate tax.

For example, the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Jobs and Growth Tax Relief Reconciliation Act of 2003

generally provided for lower income tax, capital gains and dividend tax rates that had the effect of reducing the benefits of tax deferral on the build-up of value of annuities and life insurance products. Continuation of these reduced rates, which are due to sunset in 2011, may hinder our sales and result in the increased surrender of insurance and annuity products.

Congress, as well as state and local governments, also considers from time to time legislation that could increase the amount of corporate taxes we pay. For example, changes in the law relating to tax reserving methodologies for term life or universal life insurance policies with secondary guarantees could result in higher corporate taxes. If such legislation is adopted our consolidated net income could decline.

The U.S. Treasury Department and the Internal Revenue Service have indicated that they intend to address through regulations the methodology to be followed in determining the dividends received deduction, or DRD, related to variable life insurance and annuity contracts. The DRD reduces the amount of dividend income subject to tax and is a significant component of the difference between our actual tax expense and expected amount determined using the federal statutory tax rate of 35%. A change in the DRD, including the possible retroactive or prospective elimination of this deduction through regulations or legislation, could increase our actual tax expense and reduce our consolidated net income.

On May 11, 2009, the Obama Administration released the “General Explanations of the Administration’s Revenue Proposals.” Although the Administration has not released proposed statutory language, the “General Explanations of the Administration’s Revenue Proposals” includes proposals which if enacted, would affect the taxation of life insurance companies and certain life insurance products. In particular, the proposals would affect the treatment of corporate owned life insurance policies, or COLIs, by limiting the availability of certain interest deductions for companies that purchase those policies. The proposals would also change the method used to determine the amount of dividend income received by a life insurance company on assets held in separate accounts used to support products, including variable life insurance and variable annuity contracts, that is eligible for the DRD. If proposals of this type were enacted, the Company’s sale of COLI, variable annuities, and variable life products could be adversely affected and the Company’s actual tax expense could increase, reducing earnings.

The products we sell have different tax characteristics, in some cases generating tax deductions. The level of profitability of certain of our products are significantly dependent on these characteristics and our ability to continue to generate taxable income, which are taken into consideration when pricing products and are a component of our capital management strategies. Accordingly, a change in tax law, our ability to generate taxable income, or other factors impacting the availability 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 business.

Our businesses are heavily regulated and changes in regulation may reduce our profitability.

Our business is subject to comprehensive regulation and supervision. The purpose of this regulation is primarily to protect our customers. Many of the laws and regulations to which we are subject are regularly re-examined, and existing or future laws and regulations may become more restrictive or otherwise adversely affect our operations. This is particularly the case under current market conditions.

We are subject to the rules and regulations of the SEC relating to public reporting and disclosure, accounting and financial reporting, and corporate governance matters. The Sarbanes-Oxley Act of 2002 and rules and regulations adopted in furtherance of that Act have substantially increased the requirements in these and other areas for us.

Many insurance regulatory and other governmental or self-regulatory bodies have the authority to review our products and business practices and those of our agents and employees and to bring regulatory or other legal actions against us if, in their view, our practices, or those of our agents or employees, are improper. These actions can result in substantial fines, penalties or prohibitions or restrictions on our business activities and could adversely affect our business, reputation, results of operations or financial condition. For a discussion of material pending litigation and regulatory matters, see “Contingent Liabilities and Litigation and Regulatory Matters” in the Notes to Unaudited Financial Statements included in this Quarterly Report on Form 10-Q.

Insurance regulators, as well as industry participants, have also begun to consider potentially significant changes in the way in which statutory reserves and statutory capital are determined, particularly for products with embedded options and guarantees. New regulatory capital requirements have already gone into effect for variable annuity products and new reserving requirements for these products are scheduled to be implemented as of the end of 2009. The timing of, and extent of, such changes to the statutory reporting framework are uncertain; however, the result could be increases to statutory reserves and capital, and an adverse effect on our products, sales and operating costs.

In view of recent events involving certain financial institutions, it is likely that the U.S. federal government will heighten its oversight of companies in the financial services industry such as us, including broad regulations intended to address systemic risks to the financial system. In June 2009 as part of the regulatory reform proposals on financial institutions, the Obama Administration proposed the creation of an Office of National Insurance within the U.S. Treasury. The Administration has proposed that the role of the Office of National Insurance would be to monitor the insurance industry, designate insurers or their affiliates as entities subject to regulation as “Tier 1 financial holding companies”, as discussed in the [first] risk factor above, and gather information, develop expertise, negotiate international agreements, and coordinate policy in the insurance sector. We cannot predict whether this

or other proposals will be adopted, or what impact, if any, such proposals or, if enacted, such laws, could have on our business, financial condition or results of operations. Significant regulatory changes are under consideration in other jurisdictions as well, as they consider their responses to current financial industry issues.

Compliance with applicable laws and regulations is time consuming and personnel-intensive, and changes in these laws and regulations may materially increase our direct and indirect compliance and other expenses of doing business, thus having a material adverse effect on our financial condition and results of operations.

Legal and regulatory actions are inherent in our businesses and could adversely affect our results of operations or financial position or harm our businesses or reputation.

We are, and in the future may be, subject to legal and regulatory actions in the ordinary course of our businesses. Some of these proceedings have been brought on behalf of various alleged classes of complainants. In certain of these matters, the plaintiffs are seeking large and/or indeterminate amounts, including punitive or exemplary damages. Substantial legal liability in these or future legal or regulatory actions could have an adverse effect on us or cause us reputational harm, which in turn could harm our business prospects.

Material pending litigation and regulatory matters affecting us, and certain risks to our businesses presented by such matters, are discussed under “Contingent Liabilities and Litigation and Regulatory Matters” in the Notes to Unaudited Financial Statements included in this Quarterly Report on Form 10-Q. Our litigation and regulatory matters are subject to many uncertainties, and given their complexity and scope, their outcome cannot be predicted. Our reserves for litigation and regulatory matters may prove to be inadequate. It is possible that our results of operations or cash flow in a particular quarterly or annual period could be materially affected by an ultimate unfavorable resolution of pending litigation and regulatory matters depending, in part, upon the results of operations or cash flow for such period. In light of the unpredictability of the Company’s litigation and regulatory matters, it is also possible that in certain cases an ultimate unfavorable resolution of one or more pending litigation or regulatory matters could have a material adverse effect on the Company’s financial position.

The occurrence of natural or man-made disasters could adversely affect our results of operations and financial condition.

The occurrence of natural disasters, including hurricanes, floods, earthquakes, tornadoes, fires, explosions, pandemic disease and man-made disasters, including acts of terrorism and military actions, could adversely affect our results of operations or financial condition, including in the following respects:

- Catastrophic loss of life due to natural or man-made disasters could cause us to pay benefits at higher levels and/or materially earlier than anticipated and could lead to unexpected changes in persistency rates.
- A natural or man-made disaster could result in losses in our investment portfolio or the failure of our counterparties to perform, or cause significant volatility in global financial markets.
- A terrorist attack affecting financial institutions in the United States or elsewhere could negatively impact the financial services industry in general and our business operations, investment portfolio and profitability in particular. As previously reported, in August 2004, the U.S. Department of Homeland Security identified our Newark, New Jersey facilities, along with those of several other financial institutions in New York and Washington, D.C., as possible targets of a terrorist attack.
- Pandemic disease, caused by a virus such as H5N1, the “avian flu” virus, or H1N1, the “swine flu” virus, could have a severe adverse effect on our business. The potential impact of such a pandemic on our results of operations and financial position is highly speculative, and would depend on numerous factors, including: in the case of the avian flu virus, the probability of the virus mutating to a form that can be passed easily from human to human; the effectiveness of vaccines and the rate of contagion; the regions of the world most affected; the effectiveness of treatment for the infected population; the rates of mortality and morbidity among various segments of the insured versus the uninsured population; the collectability of reinsurance; the possible macroeconomic effects of a pandemic on the Company’s asset portfolio; the effect on lapses and surrenders of existing policies, as well as sales of new policies; and many other variables.

There can be no assurance that our business continuation plans and insurance coverages would be effective in mitigating any negative effects on our operations or profitability in the event of a terrorist attack or other disaster.

Our risk management policies and procedures may leave us exposed to unidentified or unanticipated risk, which could adversely affect our businesses or result in losses.

Our policies and procedures to monitor and manage risks, including hedging programs that utilize derivative financial instruments, may not be fully effective and may leave us exposed to unidentified and unanticipated risks. The Company uses models in its hedging programs and many other aspects of its operations, including but not limited to the estimation of actuarial reserves, the amortization of deferred acquisition costs and the value of business acquired, and the valuation of certain other assets and liabilities. These models rely on assumptions and projections that are inherently uncertain. Management of operational, legal and regulatory risks requires, among other things, policies and procedures to record properly and verify a large number of transactions and events, and these policies and procedures may not be fully effective. Past or future misconduct by our employees or employees of our vendors could result in violations of law by us, regulatory sanctions and/or serious reputational or financial harm and the precautions we take to prevent and detect this activity may not be effective in all cases. A failure of our computer systems or a compromise of their security could also subject us to regulatory sanctions or other claims, harm our reputation, interrupt our operations and adversely affect our business, results of operations or financial condition.

Item 6. **Exhibits**

- 31.1 Section 302 Certification of the Chief Executive Officer.
- 31.2 Section 302 Certification of the Chief Financial Officer.
- 32.1 Section 906 Certification of the Chief Executive Officer.
- 32.2 Section 906 Certification of the Chief Financial Officer.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Pruco Life Insurance Company of New Jersey

By: /s/

Tucker I. Marr

Chief Accounting Officer

(Authorized Signatory and Principal Accounting and Financial Officer)

Date: August 14, 2009

CERTIFICATION

I, Scott D. Kaplan, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Pruco Life Insurance Company of New Jersey;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, is made known to us by others within such entity, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2009

/s/

Scott D. Kaplan
Chief Executive Officer

CERTIFICATION

I, Tucker I. Marr, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Pruco Life Insurance Company of New Jersey;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, is made known to us by others within such entity, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2009

/s/

Tucker I. Marr
Chief Financial Officer

CERTIFICATION

Pursuant to 18 U.S.C. § 1350, I, Scott D. Kaplan, Chief Executive Officer of Pruco Life Insurance Company of New Jersey (the “Company”), hereby certify that the Company’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2009 (the “Report”) fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 14, 2009

/s/

Scott D. Kaplan
Chief Executive Officer

The foregoing certification is being furnished solely pursuant to 18 U.S.C. § 1350 and is not being filed as part of the Report or as a separate disclosure document.

CERTIFICATION

Pursuant to 18 U.S.C. § 1350, I, Tucker I. Marr, Chief Financial Officer of Pruco Life Insurance Company of New Jersey (the “Company”), hereby certify that the Company’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2009 (the “Report”) fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 14, 2009

/s/

Tucker I. Marr
Chief Financial Officer

The foregoing certification is being furnished solely pursuant to 18 U.S.C. § 1350 and is not being filed as part of the Report or as a separate disclosure document.