PRUDENTIAL FINANCIAL INC
Form 10-K
February 16, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K
ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2017
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM TO
COMMISSION FILE NUMBER 001-16707

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

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

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

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, Par Value $.01	New York Stock Exchange

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

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

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

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

As of June 30, 2017, the aggregate market value of the registrant's Common Stock (par value $0.01) held by non-affiliates of the registrant was $46.18 billion and 427 million shares of the Common Stock were outstanding. As of January 31, 2018, 422 million shares of the registrant's Common Stock (par value $0.01) were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this Form 10-K incorporates by reference certain information from the Registrant's Definitive Proxy Statement for the Annual Meeting of Shareholders to be held on May 8, 2018, to be filed by the Registrant with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the year ended December 31, 2017.

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Forward-Looking Statements

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

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

PART I
ITEM 1. BUSINESS

Overview

Prudential Financial, Inc., a financial services leader with approximately $1.394 trillion of assets under management as of December 31, 2017, has operations in the United States, Asia, Europe and Latin America. Through our subsidiaries and affiliates, we offer a wide array of financial products and services, including life insurance, annuities, retirement-related services, mutual funds and investment management. We offer these products and services to individual and institutional customers through proprietary and third-party distribution networks. Our principal executive offices are located in Newark, New Jersey, and our common stock is publicly traded on the New York Stock Exchange under the ticker symbol “PRU”.

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

The results of the Closed Block, along with certain related assets and liabilities, are reported as a separate segment and treated as a divested business under Prudential Financial’s definition of adjusted operating income. The results of divested businesses are included in “Net income” in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) but are excluded from adjusted operating income. See Note 22 to the Consolidated Financial Statements for the Company’s definition of a divested business and an explanation of adjusted operating income, and see Note 12 to the Consolidated Financial Statements and “—Closed Block Division” below for more information on the Closed Block.

During the fourth quarter of 2017, we introduced a new organizational structure for our U.S. businesses that reflects our focus on leveraging our mix of businesses and our digital and customer engagement capabilities to expand our value proposition for the benefit of customers and stakeholders. This new organizational structure retains our existing segments but realigns them under new divisions. Under the new structure, our principal operations are comprised of five divisions, which together encompass seven segments, and our Corporate and Other operations. The U.S. Individual Solutions division consists of our Individual Annuities and Individual Life segments. The U.S. Workplace Solutions division consists of our Retirement and Group Insurance segments. The Investment Management division is comprised of our Investment Management segment (formerly named the Asset Management segment). The International Insurance division continues to consist of our International Insurance segment, and the Closed Block division continues to consist of our Closed Block segment. Our Corporate and Other operations continue to include corporate items and initiatives that are not allocated to business segments and businesses that have been or will be divested. There are no changes to our reporting segments nor to our measure of segment profitability as a result of the new organizational structure.

See Note 22 to the Consolidated Financial Statements for revenues, income and loss, and total assets by segment.

U.S. Individual Solutions Division

The U.S. Individual Solutions division conducts its business through the Individual Annuities and Individual Life segments.

Individual Annuities Segment

Our Individual Annuities segment manufactures and distributes individual variable and fixed annuity products, primarily to the U.S. mass affluent and affluent markets. In general, we consider households with investable assets or annual income in excess of $100,000 to be mass affluent and households with investable assets in excess of $250,000 to be affluent in the U.S. market. We focus on innovative product design and risk management strategies.

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Competition

We compete with other providers of retirement savings and accumulation products, including large, well-established insurance and financial services companies, primarily based on our innovative product features and our risk management strategies. We also compete based on brand recognition, financial strength, the breadth of our distribution platform and our customer service capabilities.

In recent years, we have experienced a dynamic competitive landscape. We proactively monitor changes in the annuity marketplace, and continue to take actions to adapt our products to the current environment in order to maintain appropriate return prospects and improve our risk profile. These actions have included variable annuity product modifications for new sales to adjust benefits pricing and commissions as well as closing of certain share classes. We also suspended or limited additional contractholder deposits for certain variable annuities with certain optional living benefit riders. Similarly, certain of our competitors have taken actions to modify benefits, to exit, or limit their presence in, the variable annuity marketplace. We have utilized external reinsurance as a form of risk mitigation, as discussed below, and incorporated provisions in the design of certain products that allow frequent revisions of key pricing elements for new business. In addition, we continue to introduce new products to broaden our offerings and diversify our risk profile, and also continue to look for opportunities to further enhance and differentiate our current suite of products to attract new customers while managing risks and responding to market conditions and regulatory changes.

Products

We offer certain variable annuities that provide our contractholders with tax-deferred asset accumulation together with a base death benefit and a suite of optional guaranteed living benefits (including versions with enhanced guaranteed minimum death benefits), and annuitization options. The majority of our currently sold contracts include an optional guaranteed living benefit which provides, among other features, the ability to make withdrawals based on the highest daily contract value plus a specified return, credited for a period of time. This contract value is a notional amount that forms the basis for determining periodic withdrawals for the life of the contractholder, and cannot be accessed as a lump sum surrender value. Certain optional living benefits can also be purchased with a companion optional death benefit, also based on a highest daily contract value. Our results are impacted by the fee rates we assess on our products. Some of our historical inforce products have fee tiers that decline throughout the life of the contract while our newer products generally have lower fee rates.

The Prudential Premier® Retirement Variable Annuity with Highest Daily Lifetime Income (“HDI”) offers lifetime income based on the highest daily account value plus a compounded deferral credit. HDI v.3.0 is the most current version of our “highest daily” guaranteed living benefits. As of December 31, 2017, $3.2 billion of HDI v.3.0 account values are reinsured to Union Hamilton Reinsurance Ltd., an external counterparty, pursuant to a quota share agreement that covered approximately 50% of new business between April 1, 2015 and December 31, 2016. New sales of HDI v.3.0 subsequent to December 31, 2016, are not covered by this external reinsurance agreement.

In 2017, we launched the Prudential Premier® Retirement Variable Annuity with Legacy Protection Plus (“LPP”), which provides an optional enhanced death benefit based on the purchase payments rolling up at a preset rate on an annual basis until certain events occur, such as the death of the first owner (or annuitant if entity-owned) or the roll-up cap is reached. LPP cannot be elected together with any of the other optional living or death benefits we offer.

The Prudential Defined Income® (“PDI”) Variable Annuity complements the variable annuity products we offer with the highest daily lifetime income benefit. PDI provides for guaranteed lifetime withdrawal payments, but restricts contractholder investment to a single bond sub-account within the separate accounts. PDI includes a living benefit rider which provides for a specified lifetime income withdrawal rate applied to purchase payment(s) paid, subject to annual roll-up increases until lifetime withdrawals commence, but does not have the highest daily feature.

We also offer variable annuities without guaranteed living benefits and immediate annuities. The Prudential Premier® Investment Variable Annuity ("PPI") offers tax-deferred asset accumulation, annuitization options and an optional death benefit that guarantees the contractholder's beneficiary a return of total purchase payments made to the contract, adjusted for any partial withdrawals, upon death.

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Excluding our PDI product, the majority of our variable annuities generally provide our contractholders with the opportunity to allocate purchase payments to sub-accounts that invest in underlying proprietary and/or non-proprietary mutual funds, frequently under asset allocation programs. Certain products also allow or require allocation to fixed-rate accounts that are invested in the general account and are credited with interest at rates we determine, subject to certain minimums. We also offer fixed annuities that provide a guarantee of principal and interest credited at rates we determine, subject to certain contractual minimums. For certain products, we have the ability to reset the crediting rates at our discretion subject to certain policy terms establishing guaranteed minimum interest crediting rates. Certain allocations made in the fixed-rate accounts of our variable annuities and certain fixed annuities impose a market value adjustment if the invested amount is not held to maturity.

In addition, most contracts also guarantee the contractholder’s beneficiary a return of total purchase payments made to the contract, adjusted for any partial withdrawals, upon death. Certain inforce contracts include guaranteed benefits which are not currently offered, such as annuitization benefits based on a guaranteed notional amount and benefits payable at specified dates after the accumulation period.

During the first quarter of 2018, we launched PruSecure℠, a single premium fixed index annuity, which allows the policyholder to allocate all or a portion of their account balance into an index account, such as the S&P 500. The index account provides interest or an interest component linked to, but not an investment in, the selected index, and its performance over the elected term (i.e., 1, 3 or 5 years), subject to certain participation rates and contractual minimums and maximums. We also anticipate the launch of Guaranteed Income for Tomorrow (“GIFT℠”), a deferred income annuity, which initially will be distributed through direct response solicitation through our Group Insurance business.

For information regarding the risks inherent in our products and the mitigants we have in place to limit our exposure to these risks, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Results of Operations by Segment—U.S. Individual Solutions Division—Individual Annuities—Variable Annuity Risks and Risk Mitigants.”

Marketing and Distribution

Our annuity products are distributed through a diverse group of third-party broker-dealers and their representatives, banks and wirehouses, independent financial planners and, for our GIFT product, direct response solicitation through our Group Insurance business. Additionally, our variable annuity products are distributed through financial professionals, including those associated with Prudential Advisors, an affiliated broker-dealer. Our distribution efforts are supported by a network of internal and external wholesalers.

For information regarding the U.S. Department of Labor (“DOL”) fiduciary rule and its impact on our Individual Annuities segment, see “Regulation—ERISA and DOL Fiduciary Rules” below.

Underwriting and Pricing

We earn asset management fees determined as a percentage of the average assets of our proprietary mutual funds in our variable annuity products, net of sub-advisory expenses related to non-proprietary sub-advisors. Additionally, we earn mortality, expense and other fees for various insurance-related options and features based on the average daily net asset value of the annuity separate accounts, account value, premium, or guaranteed value, as applicable. We also receive administrative service and distribution fees from many of the proprietary and non-proprietary mutual funds.

We price our variable annuities based on an evaluation of the risks assumed and consideration of applicable risk management strategies, including hedging and reinsurance costs. Our pricing is also influenced by competition and assumptions regarding contractholder behavior, including persistency (the probability that a policy or contract will remain in force), benefit utilization and the timing and efficiency of withdrawals for contracts with living benefit features, as well as other assumptions. Significant deviations in actual experience from our pricing assumptions could have an adverse or positive effect on the profitability of our products. To encourage persistency, most of our variable and fixed annuities have surrender or withdrawal charges for a specified number of years. In addition, the living benefit features of our variable annuity products encourage persistency because the potential value of the living benefit is fully realized only if the contract persists.

We price our fixed annuities and the fixed-rate accounts of our variable annuities based on assumed investment returns, expenses, competition and persistency, as well as other assumptions. We seek to maintain a spread between the return on our general account invested assets and the interest we credit on our fixed annuities and the fixed-rate accounts of our variable annuities.

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Reserves

We establish reserves for our annuity products in accordance with U.S. GAAP. We use current best estimate assumptions when establishing reserves for our guaranteed minimum death and income benefits, including assumptions such as interest rates, equity returns, persistency, withdrawal, mortality and annuitization rates. Certain of the guaranteed living benefit features on our variable annuity contracts are accounted for as embedded derivatives and are carried at fair value. The fair values of these benefit features are calculated as the present value of future expected benefit payments to contractholders less the present value of future expected rider fees attributable to the embedded derivative feature, and are based on assumptions a market participant would use in valuing these embedded derivatives. For life contingent payout annuity contracts, we establish reserves using best estimate assumptions with provisions for adverse deviations as of inception or best estimate assumptions as of the most recent loss recognition event. For variable and fixed annuity contracts, we establish liabilities for contractholders' account balances that represent cumulative deposits plus credited interest, less withdrawals, mortality and expense charges. Policyholders' account balances also include provisions for non-life contingent payout annuity benefits. For information on developments regarding statutory reserves for variable annuities, see "Regulation—U.S. Insurance Operations—State Insurance Regulation—Financial Regulation—Variable Annuities" below.

Individual Life Segment

Our Individual Life segment manufactures and distributes universal life, term life and variable life insurance products primarily to the U.S. mass middle, mass affluent and affluent markets. In general, we consider: households with investable assets in excess of $25,000 or annual income in excess of $50,000 to be mass middle; households with investable assets or annual income in excess of $100,000 to be mass affluent; and households with investable assets in excess of $250,000 to be affluent in the U.S. market. Our life products are distributed through independent third-party distributors and licensed sales professionals within Prudential Advisors. We generally experience higher sales during the fourth quarter as some of our clients use life insurance for estate and tax planning purposes.

Competition

The Individual Life segment competes with other large, well-established life insurance companies in a mature market. We compete primarily based on price, service, including the speed and ease of underwriting, distribution channel relationships, brand recognition and financial strength. Due to the large number of competitors, pricing is competitive. Factors that could influence our ability to competitively price products while achieving targeted returns include the level, cost and availability of financing for statutory reserves required for certain term life insurance policies, the availability, utilization and timing of tax deductions associated with statutory reserves, product designs that impact the amount of statutory reserves and the associated tax deductions, the timing of principles-based reserving adoption, the level and volatility of interest rates, and our expense structure.

We periodically adjust product prices and features based on the market and our strategy, with a goal of managing the Individual Life business for steady, consistent sales growth across a balanced product portfolio and to avoid over-concentration in any one product type. These actions, and the actions of competitors, can impact our sales levels from period to period.

Products

Our primary insurance products are term life, variable life, guaranteed universal life and all other universal life, which represent 47%, 31%, 15% and 7%, respectively, of our face amount of individual life insurance in force, net of reinsurance as of December 31, 2017. We continue to maintain focus on our product diversification strategy which has positioned us to better balance portfolio risk and enhance our value proposition to our distribution partners and their clients. Additionally, most of our variable and universal life products offer a policy rider that allows death benefits to be accelerated to the policyholder during a chronic or terminal illness, under certain contractual requirements.

Term Life Insurance. We offer a variety of term life insurance products that provide coverage for a specified time period. Most term products include a feature that allows the policyholder to convert the policy into permanent life insurance coverage. We also offer 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 demand for term life insurance protection.

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Variable Life Insurance. We offer several variable life insurance products that give the policyholder the flexibility to change both the death benefit and premium payments, and provide the potential to earn returns linked to an underlying investment portfolio that the policyholder selects. The policyholder generally can make deposits for investments in a fixed-rate option which is part of our general account or in separate account investment options consisting of equity and fixed income funds. Any policyholder investments in the fixed-rate option provide a guarantee of principal and are credited with interest at rates that we determine, subject to certain contractual minimums. In the separate accounts, the policyholder bears the underlying portfolio performance risk. We also offer a variable life product that has an optional flexible guarantee against lapse where policyholders can select the guarantee period. While variable life insurance continues to be an important product, marketplace demand continues to favor term and universal life insurance. A meaningful portion of Individual Life's profits, however, is associated with our large in force block of variable life insurance policies which are expected to run off over time as policies age.

Universal Life Insurance. We offer universal life insurance products that feature flexible premiums and a crediting rate that we determine, subject to certain contractual minimums. Guaranteed universal life products provide a guarantee of death benefits to remain in force when a policy would otherwise lapse due to insufficient cash value. We also offer universal life insurance products that allow the policyholder to allocate all or a portion of their account balance into an index account. The index account provides interest or an interest component linked to, but not an investment in, S&P 500 index performance over the following year, subject to certain participation rates and contractual minimums and maximums. Mortality and expense margins and net interest spread impact Individual Life's profits from universal life insurance.

Marketing and Distribution

Individual Life provides products through the following two channels:

Third-Party Distribution. Our individual life products are offered through a variety of third-party channels, including independent brokers, wirehouses, banks, general agencies and producer groups. We focus on sales through independent intermediaries who provide life insurance solutions to protect individuals, families and businesses and support estate and wealth transfer planning.

Prudential Advisors. Prudential Advisors distributes Prudential universal, term and variable life insurance, variable and fixed annuities and investment products with proprietary and non-proprietary investment options, as well as selected insurance and investment products from other carriers and has access to non-proprietary property and casualty products. In addition, Prudential Advisors offers certain retail brokerage and retail investment advisory services through our dually registered broker-dealer and investment advisor, Pruco Securities, LLC. These services include brokerage accounts, discretionary and non-discretionary investment advisory programs and financial planning services. Although Prudential Advisors generates an operating loss within our Individual Life segment, it generates positive overall value when we consider the aggregate value of the business that is acquired through this channel. Individual Life is paid a market rate by the Individual Annuities and Investment Management segments to distribute their products. Any profit or loss is included in the results of the Individual Life segment and eliminated in consolidation.

For information regarding the DOL fiduciary rule and its impact on our Individual Life segment, see "Regulation—ERISA and DOL Fiduciary Rules" below.

Underwriting and Pricing

Underwriters assess and quantify the risk of our individual life insurance products based on the age, gender, health and occupation of the applicant and amount of insurance requested. We continually update our guidelines to keep pace with changes in healthcare, research, and experience. We have also introduced new underwriting approaches designed to selectively accelerate and enhance the existing underwriting process. We base premiums and policy charges for individual life insurance on expected death benefits, surrender benefits, expenses and required reserves. We price policies using assumptions for mortality and morbidity, interest rates, expenses, policy persistency, premium payment patterns, separate account fund performance and product-generated tax deductions, as well as the level, cost and availability of financing certain statutory reserves. Deviations in actual experience from our pricing assumptions may adversely or positively impact the profitability of our products.

Reserves

We establish reserves for individual life products in accordance with U.S. GAAP. For term life insurance policies and other benefits with fixed and guaranteed terms, we use best estimate assumptions with provisions for adverse deviation as of inception when establishing reserves for future policyholder benefits and expenses including assumptions for mortality, investment yield, expenses, and policy persistency. We use current best estimate assumptions when establishing reserves for no lapse guarantees, which includes an assumption for future premium payments. Reserves also include claims reported but not yet paid, and claims incurred but not yet reported. In certain instances, the reserves for a particular line of business may not be deficient in the aggregate, but the pattern of earnings may be such that profits are expected to be recognized in earlier years followed by losses in later years. In these situations, we record an additional liability (Profits Followed by Losses or "PFL" liability) in an amount necessary to sufficiently offset the losses that would be recognized in later years. For variable and universal life insurance policies, we establish liabilities for policyholders' account balances. These liabilities represent cumulative deposits plus credited interest, less withdrawals, and expense and cost of insurance charges, as applicable. Policyholders' account balances also include unearned revenue reserves calculated based on current best estimate assumptions. For a discussion of developments regarding principles based reserving for statutory reserves, see "Regulation—U.S. Insurance Operations—State Insurance Regulation—Financial Regulation—Insurance Reserves and Regulatory Capital," and for a discussion of our statutory life product reserves and reserve financing see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Capital—Financing Activities—Term and Universal Life Reserve Financing."

Reinsurance

The Individual Life segment uses reinsurance as a means of managing mortality volatility and risk capacity, which can impact product profitability. On policies sold since 2000, we have reinsured a significant portion of the mortality risk assumed, with that portion varying over time depending on market factors and strategic objectives. We remain liable if a third-party reinsurer is for some reason unable to meet its obligations. On a Company-wide basis, we evaluate the financial condition of reinsurers and monitor the concentration of counterparty risk to mitigate this exposure.

U.S. Workplace Solutions Division

The U.S. Workplace Solutions division conducts its business through the Retirement and Group Insurance segments.

Retirement Segment

Our Retirement segment, which we refer to in the marketplace as Prudential Retirement, provides retirement investment and income products and services to retirement plan sponsors in the public, private and not-for-profit sectors. Our full service business provides recordkeeping, plan administration, actuarial advisory services, tailored participant education and communication services, trustee services and institutional and retail investments. We service defined contribution, defined benefit and non-qualified plans. For clients with combinations of these plans, we offer integrated recordkeeping services. We also provide certain brokerage services through our broker-dealer, Prudential Investment Management Services LLC, and trust services through Prudential Bank & Trust, FSB ("PB&T"), a limited purpose trust-only institution. Our institutional investment products business includes both payout annuity and stable value products. Payout annuities include pension risk transfer products, structured settlements and other group annuities for defined contribution plans, defined benefit plans, non-qualified plans and individuals. Stable value products include investment-only wraps, guaranteed investment contracts ("GICs") and funding agreements.

Competition

The Retirement segment competes with other large, well-established insurance companies, asset managers, recordkeepers and diversified financial institutions. In our full service business, we compete primarily based on pricing, the breadth of our service and investment offerings, the expertise of our employees, investment performance and our ability to offer product features to meet the retirement income needs of our clients. We collect revenue based on assets or per participant charges for plan administration, recordkeeping and employee education services. While we continue to have heightened pricing pressures, driven by competition, contractual limits on fee income, the influence of intermediaries and regulations requiring more standard and consistent fee disclosures across industry providers, this business has experienced strong persistency in recent years.

In our institutional investment products business, we compete primarily based on our pricing and structuring capabilities, as well as our ability to offer innovative product solutions and successfully execute large-scale transactions. Sales of institutional investment products are affected by competitive factors such as investment performance, company credit and financial strength ratings, product design, marketplace visibility, distribution capabilities, fees, crediting rates and customer service. We are a leader in providing innovative pension risk management solutions to plan sponsors and in the stable value wrap market. We believe the pension risk transfer market continues to offer attractive opportunities that are aligned with our expertise.

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Products and Services

Full Service

Our full service business offers plan sponsors and their participants a broad range of products and services to assist in the design, delivery and administration of defined contribution, defined benefit, and non-qualified plans, including recordkeeping and administrative services, comprehensive investment offerings and consulting services to assist plan sponsors in managing fiduciary obligations. As part of our investment products, we offer a variety of general and separate account stable value products and other fee-based separate accounts, as well as retail mutual funds and institutional funds advised by affiliated and non-affiliated investment managers. In addition, certain products are marketed and sold on an investment-only basis through our full service distribution channels.

Our full service general account and separate account stable value products contain an obligation to pay interest at a specified rate for a specific period of time and to repay account balances or market value upon contract termination. These stable value products are either fully or partially participating, with annual or semi-annual rate resets subject to certain contractual minimums, giving effect to previous investment experience. We earn profits from partially participating products from the spread between the rate of return we earn on the investments and the interest rates we credit, net of expenses. In addition, we may earn administrative fees for providing recordkeeping and other administrative services for both fully and partially participating products.

We also offer fee-based products, through which customer funds are held in separate accounts, retail mutual funds, institutional funds or a client-owned trust. These products generally pass all of the investment results to the customer. In certain cases, these contracts are subject to a minimum interest rate guarantee backed by the general account. Additionally, we offer guaranteed minimum withdrawal benefits associated with certain defined contribution accounts and manage certain of the related risks with derivatives and other hedging instruments.

Our full service fee-based advisory offerings are supported by participant communications and education programs, and a broad range of plan consulting services, including non-discrimination testing, plan document services, signature-ready documents for required filings, and full actuarial support for defined benefit plans. Additional services include non-qualified deferred compensation plan administration, including executive benefit solutions and financing strategies, investment advisory services, and merger and acquisition support.

Institutional Investment Products

Our institutional investment products business primarily offers products to the payout annuity and stable value markets.

Payout Annuity Markets. We offer products designed to provide a predictable source of monthly income, generally for the life of the participant. Our pension risk transfer products include portfolio-protected products and a longevity reinsurance product. Our portfolio-protected products are non-participating group annuity contracts which we issue to pension plan sponsors and assume all of the investment and actuarial risk associated with a group of specified participants within a plan in return for a premium typically paid as a lump sum at inception. These products have economic features similar to our other general account annuity contracts, discussed below, but may also offer the added protection of an insulated separate account. Our longevity reinsurance product is a reinsurance contract from which we earn a fee for assuming the longevity risk of pension plans that have been insured by third-parties, typically with monthly net settlements of premiums and benefits. As of December 31, 2017, our pension risk transfer business in force had an approximate average age of 76 years.

Other products include structured settlements, voluntary income products and other group annuities, which fulfill the payment guarantee needs of the personal injury lawsuit settlement market, the distribution needs of defined contribution participants and the payment obligations of defined benefit plans, respectively. For our general account products, we bear all of the investment, mortality, retirement, asset/liability management, and expense risk associated with these contracts. Our profits reflect the emerging experience related to investment returns, timing of mortality, timing of retirement and the level of expenses being more or less favorable than assumed in the original pricing. Our separate account products are primarily fee-based products that cover payments to be made to defined benefit plan retirees. These contracts permit a plan sponsor to retain the risks and rewards of investment and actuarial results while receiving a general account guarantee for all annuity payments covered by the contract.

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Stable Value Markets. We manufacture investment-only products for use in retail and institutional capital markets and qualified plan markets. Our primary stable value product offerings are investment-only wraps through which customers' funds are held in a client-owned trust. These are participating contracts for which investment results pass through to the customer, subject to a minimum interest rate guarantee backed by the general account, and we earn fees for providing this guarantee. For contracts currently in force, the minimum interest rate has a floor of zero percent. The fees we earn for providing this guarantee may be reset as defined by the underlying contracts. Contractholders are provided with proprietary and non-proprietary fund investment alternatives.

We also offer investment-only general account products in the form of GICs and funding agreements. These products contain an obligation to pay interest at a specified rate and to repay principal at maturity or following contract termination. Because these obligations are backed by our general account, we bear the investment and asset/liability management risk associated with these contracts. Generally, profits from these products result from the spread between the rates of return we earn on the investments and the interest rates we credit, net of expenses.

Marketing and Distribution

We distribute our products through a variety of channels. In our full service business, our dedicated sales and support teams manage our distribution efforts in offices across the country. We sell our products and services through third-party financial advisors, brokers, and benefits consultants and, to a lesser extent, directly to plan sponsors. Our clients typically prefer to transition plans either at the beginning or end of their fiscal year, which are generally during our fourth quarter.

In our payout annuity area within our institutional investment products business, our pension risk transfer products, traditional group annuities and participating separate account annuities are typically distributed through actuarial consultants and third-party brokers. Structured settlements are distributed through unaffiliated specialized brokers. Voluntary income products are distributed through the defined contribution portion of our full service business, directly to plan sponsors, or as part of annuity price quoting services.

In our stable value area within our institutional investment products business, we utilize our direct sales force and intermediaries to distribute investment-only stable value wraps and traditional GICs to plan sponsors and stable value fund managers, and to distribute funding agreements to investors. We also manage a global Funding Agreement Notes Issuance Program ("FANIP") pursuant to which statutory trusts issue short-term commercial paper and/or medium-term notes secured by funding agreements issued to the trusts by Prudential Insurance. Prudential Insurance may also issue funding agreements directly to the Federal Home Loan Bank of New York.

For information regarding the DOL fiduciary rule and its impact on our Retirement segment, see "Regulation—ERISA and DOL Fiduciary Rules" below.

Underwriting and Pricing

We set our rates for our full service and institutional investment products using pricing models that consider the investment environment and our risk, expense and profitability targets. In addition, for products within our payout annuity area, our models also use assumptions for mortality and, if pertinent, early retirement risks. These assumptions may be less predictable in certain markets, and deviations in actual experience from pricing assumptions could affect the profitability of these products. For our investment-only stable value wrap product, our pricing risk is mitigated by several features, including: the fees we earn for providing a guaranteed rate of return may be reset, as defined by the underlying contracts; the contracts allow participants to withdraw funds at book value, while contractholder withdrawals occur at market value immediately or at book value over time; and our obligation is limited to payments that are in excess of the fund value.

Reserves

We establish reserves for our retirement products in accordance with U.S. GAAP. We use best estimate assumptions with provisions for adverse deviation as of inception or best estimate assumptions as of the most recent loss recognition event when establishing reserves for future policyholder benefits and expenses, including assumptions for investment yield, expenses, mortality rates, persistency and retirement. Future policyholder benefit reserves also include amounts related to deferred profit liabilities, where applicable. We also establish liabilities for policyholders' account balances and additional reserves for investment experience that will accrue to the customer but have not yet been reflected in credited rates. Policyholders' account balances also include provisions for non-life contingent payout annuity benefits.

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Group Insurance Segment

Our Group Insurance segment offers a full range of group life, long-term and short-term group disability, and group corporate-, bank- and trust-owned life insurance in the U.S. primarily to institutional clients for use in connection with employee plans and affinity groups. We also sell accidental death and dismemberment and other ancillary coverages, and provide plan administrative services in connection with our insurance coverages.

Competition

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

Products

Group Life Insurance. Our portfolio of group life insurance products consists of employer-paid (basic) and employee-paid coverages, including term life insurance for employees and employees' dependents, and group universal life insurance. We offer group variable universal life insurance, basic and voluntary accidental death and dismemberment insurance, a critical illness product and an accident insurance product. Many of our employee-paid coverages allow employees to retain their coverage when they change employers or retire. We also offer waiver of premium coverage where required premiums are waived in the event the insured suffers a qualifying disability.

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

Group Disability Insurance. We offer short- and long-term group disability insurance, which protects against loss of wages due to illness or injury, as well as plan administrative services and absence management services. Disability benefits are limited to a portion, generally 50% to 70%, of the insured's earned income up to a specified maximum benefit. Short-term disability generally provides a weekly benefit for three to six months, while long-term disability benefits are paid monthly, following a waiting period (usually 90 or 180 days, during which short-term disability may be provided) and generally continue until the insured returns to work or reaches normal retirement age.

Marketing and Distribution

Group Insurance offers its portfolio of products and customized benefit solutions through its own dedicated sales force that is organized around market segments and distributes primarily through employee benefit brokers and consultants.

Underwriting and Pricing

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

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

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Reserves

We establish reserves for group insurance products in accordance with U.S. GAAP. We primarily use current best estimate assumptions when establishing reserves for future policyholder benefits and expenses including assumptions for mortality, morbidity and claim termination rates, interest rates and Social Security offsets. Reserves also include claims reported but not yet paid, and claims incurred but not yet reported. We also establish liabilities for policyholders' account balances that represent cumulative deposits plus credited interest, less withdrawals, and expense and cost of insurance charges, as applicable.

Reinsurance

We use reinsurance primarily to limit losses from large claims, and in response to client requests. We may from time to time also use reinsurance for capital management purposes. We remain liable if a third-party reinsurer is for some reason unable to meet its obligations. On a Company-wide basis, we evaluate the financial condition of reinsurers and monitor concentration of counterparty risk to mitigate this exposure.

Investment Management Division

The Investment Management division conducts its business through the Investment Management segment.

Investment Management Segment

The Investment Management segment provides a broad array of investment management and advisory services by means of institutional portfolio management, retail funds management, private lending and asset securitization activity and other structured products. These products and services are provided to third-party clients and to other Prudential businesses. We also invest in asset management and investment distribution businesses in targeted countries, including through investments in operating joint ventures, to expand our mass affluent customer base outside the U.S. and to increase our global assets under management.

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

Competition

The Investment Management segment competes with numerous asset managers and other financial institutions. For our investment management products, we compete based on a number of factors, including investment performance, strategy and process, talent, organizational stability and client relationships. We offer products across multiple asset classes, with specialized investment teams that employ approaches designed to add value in each product area or asset class. Our organizational stability and robust institutional and retail businesses have helped attract and retain talent critical to delivering investment results for clients. Our private placement and commercial mortgage businesses compete based on price, terms, execution and the strength of our relationship with the borrower. Competition will vary depending on the product or service being offered.

Products and Services

We offer asset management services for public and private fixed income, public equity and real estate, as well as commercial mortgage origination and servicing, and mutual funds and other retail services through the following eight businesses:

PGIM Fixed Income. PGIM Fixed Income manages assets for a wide range of clients worldwide through our operations in Newark, London, Singapore and Tokyo. Our products include traditional broad market fixed income and single-sector strategies, traditional and customized asset/liability strategies, hedge strategies and collateralized loan obligations. PGIM Fixed Income also serves as a non-custodial securities lending agent. Portfolios are managed by seasoned portfolio managers across sector specialist teams supported by significant credit research, quantitative research and risk management organizations.

Jennison Associates. Jennison Associates LLC, a wholly-owned registered investment adviser, provides discretionary and non-discretionary asset management services by managing a range of publicly-traded equity, balanced and fixed income portfolios that span market capitalizations, investment styles and geographies. Jennison Associates uses fundamental, team-based research to manage portfolios for institutional, private and sub-advisory clients, including mutual funds.

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Quantitative Management Associates, a PGIM Company. Quantitative Management Associates LLC, a wholly-owned registered investment adviser, provides discretionary and non-discretionary asset management services to a wide range of clients by managing a broad array of publicly-traded equity asset classes using various investment styles. Quantitative Management Associates manages equity and asset allocation portfolios for institutional and sub-advisory clients, including mutual funds, using proprietary quantitative processes tailored to meet client objectives.

Prudential Capital Group. Prudential Capital Group provides asset management services by investing in private placement investment grade and below investment grade debt and mezzanine debt and equity securities, with a majority of the private placement investments being originated by our staff. These investment capabilities are utilized by our general account and institutional clients through direct advisory accounts, insurance company separate accounts, and private fund structures.

PGIM Real Estate Finance. PGIM Real Estate Finance provides commercial mortgage origination, asset management and servicing for our general account, institutional clients, and government sponsored entities such as Fannie Mae, the Federal Housing Administration and Freddie Mac.

PGIM Real Estate. PGIM Real Estate provides asset management services for single-client and commingled private and public real estate portfolios, and manufactures and manages a variety of real estate investment vehicles investing in private and public real estate, primarily for institutional clients through offices worldwide. Our domestic and international real estate investment vehicles range from fully diversified open-end funds to specialized closed-end funds that invest in specific types of properties or designated geographic regions or follow other specific investment strategies. Our global real estate organization has an established presence in the U.S., Europe, Asia and Latin America.

PGIM Investments. PGIM Investments manufactures, distributes and services investment management products primarily utilizing proprietary asset management expertise in the U.S. retail market. These products are designed to be sold primarily by financial professionals including third-party advisors and licensed sales professionals within Prudential Advisors. We offer a family of retail investment products consisting of over 70 mutual funds as of December 31, 2017. These products cover a wide array of investment styles and objectives designed to attract and retain assets of individuals with varying objectives and to accommodate investors’ changing financial needs.

PGIM Global Partners. PGIM Global Partners operates an asset management business in Taiwan and has interests in asset management operating joint ventures in Brazil, India and Italy, which are accounted for under the equity method. Each of these businesses offers mutual funds and serves individual and institutional investors and clients.

In addition, we make strategic investments to support the creation and management of funds offered to third-party investors in private and public real estate, fixed income and publicly traded equity asset classes. Certain of these investments are made primarily for purposes of co-investment in our managed funds and structured products. Other strategic investments are made with the intention to sell or syndicate to investors, including our general account, or for placement in funds and structured products that we offer and manage (seed investments). We also make loans to, and guarantee obligations of, our managed funds that are secured by equity commitments from investors or assets of the funds.

Marketing and Distribution

We provide investment management services for our institutional customers through a proprietary sales force organized by each investment management business. Each business has an independent marketing and service team working with clients. Institutional asset management services are also offered through the Retirement segment.

Most of the retail customer assets under management are invested in our mutual funds and our variable annuities and variable life insurance products. These assets are gathered by distribution forces associated with other Prudential businesses and by third-party networks. Additionally, we work with third-party product manufacturers and distributors to include our investment options in their products and platforms.

We also provide investment management services across a broad array of asset classes for our general account, as described under "Management's Discussion and Analysis of Financial Condition and Results of Operations—General Account Investments."

For information regarding the DOL fiduciary rule and its impact on our Investment Management segment, see "Regulation—ERISA and DOL Fiduciary Rules" below.

International Insurance Division

The International Insurance division conducts its business through the International Insurance segment.

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International Insurance Segment

Our International Insurance segment manufactures and distributes individual and group life insurance, retirement and related products, including certain health and personal accident products with fixed benefits. We provide these products to the mass affluent and affluent markets through our Life Planner operations in Japan, Korea and other countries outside the U.S., including Taiwan, Italy, Brazil, Argentina, Poland and Mexico. We also provide similar products to the broad middle income and mass affluent markets across Japan through multiple distribution channels including banks, independent agencies and Life Consultants associated with our Gibraltar Life Insurance Company, Ltd. (“Gibraltar Life”) operations.

For the year ended December 31, 2017, our Life Planner and Gibraltar Life operations in Japan represented 37% and 49%, respectively, of the net premiums, policy charges and fee income of the International Insurance segment and, in aggregate, represented 37% of the net premiums, policy charges and fee income of Prudential Financial, translated on the basis of weighted average monthly exchange rates.

In addition to the operations discussed above, we continue to seek opportunities for expansion into targeted countries with attractive markets and long-term growth potential, as well as opportunities to go deeper into countries where we already have a presence. When entering these markets, we often do so with a partner that may offer expertise, distribution capabilities or an existing footprint in the targeted market. As of December 31, 2017, we have a 40% interest in a retirement services business in Chile, a 70% interest in a life insurance business in Malaysia, a 49% interest in a life insurance joint venture in India and a 49% interest in a life insurance joint venture in Indonesia. The joint venture in Indonesia was entered into in 2017 with CT Corp and is expected to take a multi-product and multi-channel distribution approach. In April 2017, we completed the purchase of a group life insurance business from Itaú Unibanco S.A., which provides group life and personal accident insurance products to corporate clients through a network of third-party brokers in Brazil. In June 2017, LeapFrog Strategic African Investments (“LSAI”), a fund in which we are the primary investor, signed an agreement to acquire a minority interest in Enterprise Group Limited and affiliates (“Enterprise Group”). Enterprise Group offers financial services including life insurance and pensions for emerging markets consumers in Ghana. This transaction closed in August 2017.

We also regularly review our existing international businesses and may seek to exit an operation if it is determined that it no longer aligns with our broader international strategy. In January 2018, we entered into a definitive agreement to sell our Pramerica of Poland subsidiary. The transaction is expected to close in 2018, subject to regulatory approvals and customary closing conditions.

We manage each operation on a stand-alone basis through local management and sales teams, with oversight by senior executives based in Newark, New Jersey and outside the United States. Each operation has its own marketing, underwriting, claims, investment management and actuarial functions. In addition, significant portions of the general account investment portfolios are managed by our Investment Management segment, primarily through international subsidiaries. Our operations generally invest in local currency denominated securities, primarily bonds issued by the local government or its agencies. In our larger operations, we have more diversified portfolios that also include U.S. dollar-denominated investments, in large part to support products issued in U.S. dollars and as part of our foreign exchange hedging strategy. Our Gibraltar Life operations also have Australian dollar-denominated investments that support products issued in that currency.

Competition

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

Products

Our international insurance operations have a diversified product mix, primarily emphasizing death protection while supporting the growing demand for retirement and savings products. Outside of Japan, our products are generally denominated in local currency. Within Japan, as a result of both the continued low interest rate environment and fluctuating currency markets, there has been a shift in demand for certain products, particularly for those denominated in U.S. dollars, which currently comprise a significant portion of new sales. In addition, we regularly examine our product offerings and particularly in Japan have taken specific actions to reprice or, in some cases, suspend sales of products that are most affected by such factors, including low interest rates.

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We classify our products into four general categories: life insurance protection, retirement, annuity and accident & health, which represented 62%, 19%, 13% and 6%, respectively, of full year 2017 annualized new business premiums on a constant exchange rate basis. Each product category is described below:

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

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

Annuity Products. Annuity products are primarily represented by U.S. and Australian dollar-denominated fixed annuities sold by our Gibraltar Life operations in Japan and Korean won- and U.S. dollar-denominated variable annuities sold by our Life Planner operation in Korea. Sales and surrenders of non-yen products can be sensitive to foreign currency relationships which are impacted by, among other things, the comparative interest rates in the respective countries. Most of our fixed annuity products impose a market value adjustment if the contract is not held to maturity.

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

Marketing and Distribution

Our International Insurance segment distributes its products through multiple distribution channels, including two captive agent models, Life Planners and Life Consultants, as well as bank and independent agency third-party distribution channels. For additional information on headcount for our captive agents, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Results of Operations by Segment—International Insurance Division."

Life Planners. Our Life Planner model differentiates us from competitors in the countries where we do business by focusing on selling protection-oriented life insurance products on a needs basis to mass affluent and affluent customers, as well as retirement-oriented products to small businesses. We believe that our recruiting and selection process, training programs and compensation packages are key to the Life Planner model and have helped our Life Planner operations achieve higher levels of agent retention, agent productivity and policy persistency. The attributes considered when recruiting new Life Planners generally include but are not limited to: university or college degree, no prior life insurance sales experience, a minimum of two years of sales or sales management experience, and a pattern of job stability and success. The number of Life Planners as of December 31, 2017 and 2016, was 7,831 and 7,680, respectively.

Life Consultants. Our Life Consultants are the proprietary distribution force for products offered by our Gibraltar Life operations. Their focus is to provide individual protection products to the broad middle income market, primarily in Japan, particularly through relationships with affinity groups. Our Life Consultant operation is based on a variable compensation plan designed to improve productivity and persistency that is similar to compensation plans in our Life Planner operations. The number of Life Consultants in Japan as of December 31, 2017 and 2016, was 8,326 and 8,884, respectively.

Bank Distribution Channel. Bank distribution channel sales primarily consist of life insurance products intended to provide savings features, premature death protection and estate planning benefits as well as fixed annuity products primarily denominated in U.S. and Australian dollars. We view the bank distribution channel as an adjunct to our core Life Planner and Life Consultant distribution channels and will continue to pursue this channel with a focus on profitable growth.

A significant portion of our sales in Japan through our bank channel distribution are derived through a single Japanese mega-bank; however, we have relationships with each of Japan’s four largest banks as well as many regional banks, and we continue to explore opportunities to expand our distribution capabilities through this channel, as appropriate.

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Independent Agency Distribution Channel. Our independent agency channel sells protection products and high cash value products for retirement benefits through the business market and sells a variety of other products including protection, medical and fixed annuity products through the individual market. Our focus is to maintain a diverse mix of independent agency relationships including accounting firms, corporate agencies and other independent agencies with a balanced focus on individual and business markets. We differentiate ourselves by providing quality service to producers in this distribution channel.

Underwriting and Pricing

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

Pricing of products is designed to achieve a targeted rate of return for each country, taking into account the country-specific costs of capital, risks, and competitive environment. The profitability of our products is impacted both positively and negatively by differences between actual mortality, morbidity, expense, and investment experience and the related assumptions used in pricing these policies. As a result, the profitability of our products can fluctuate from period to period. Interest rates guaranteed at issue under our insurance contracts may exceed the rates of return we earn on our investments and, as a result, we may experience negative spreads between the rate we guarantee and the rate we currently earn on investments. Additionally, profitability within any reporting period may also be affected by seasonal factors, such as common retirement dates for members of specific customer groups in the second quarter of each year, or the timing of new product introductions, sales campaigns and premium rate changes. Changes in local tax laws may also affect profitability.

Reserves

We establish reserves for our international insurance products in accordance with U.S. GAAP. We primarily use best estimate assumptions with provisions for adverse deviation as of inception when establishing reserves for future policyholder benefits and expenses including assumptions for investment yield, persistency, expenses, mortality and morbidity rates. Future policy benefit reserves also include amounts related to our deferred profit liability, claims reported but not yet paid, and claims incurred but not yet reported. For variable and interest-sensitive life products, as well as most annuity products, we establish liabilities for policyholders’ account balances that represent cumulative deposits plus credited interest, less withdrawals, and expense and cost of insurance charges, as applicable. Policyholders’ account balances also include unearned revenue reserves calculated based on current best estimate assumptions and provisions for non-life contingent payout annuity benefits.

Reinsurance

International Insurance reinsures portions of its insurance risks, primarily mortality, with both selected third-party reinsurers and Prudential Insurance. International Insurance may from time to time also reinsure risks to other affiliates. We remain liable if a third-party reinsurer is for some reason unable to meet its obligations. On a Company-wide basis, we evaluate the financial condition of reinsurers and monitor the concentration of credit risk to mitigate this exposure.

Corporate and Other Operations

Our Corporate and Other operations include corporate items and initiatives that are not allocated to business segments and businesses that have been or will be divested. Results of the Closed Block, along with certain related assets and liabilities, are reported as the Closed Block division and are accounted for as a divested business that is reported separately from the divested businesses included in Corporate and Other.

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Corporate Operations

Corporate Operations consist primarily of: (1) capital that is not deployed in any business segment; (2) investments not allocated to business segments, including debt-financed investment portfolios, as well as tax credit investments and other tax-enhanced investments financed by business segments; (3) capital debt that is used or will be used to meet the capital requirements of the Company and the related interest expense; (4) our qualified and non-qualified pension and other employee benefit plans, after allocations to business segments; (5) corporate-level activities, after allocations to business segments, including strategic expenditures, corporate governance, corporate advertising, philanthropic activities, deferred compensation, and costs related to certain contingencies and enhanced regulatory supervision; (6) certain retained obligations relating to pre-demutualization policyholders; (7) a life insurance joint venture and an asset management joint venture in China; (8) our Capital Protection Framework, discussed below; (9) the foreign currency income hedging program used to hedge certain non-U.S. dollar denominated earnings in our International Insurance segment; (10) the impact of intercompany arrangements with our Retirement and Investment Management segments to translate certain non-U.S. dollar-denominated earnings at fixed currency exchange rates; and (11) transactions with and between other segments, including the elimination of intercompany transactions for consolidation purposes.

Corporate Operations include certain results related to our Capital Protection Framework ("the Framework"), which we employ as part of our capital management strategy. The Framework addresses the potential capital consequences under a range of market related stresses and the strategies we use to mitigate them. For additional information on our Capital Protection Framework, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Capital—Capital Protection Framework."

Divested Businesses

Divested Businesses reflect the results of the following businesses that have been, or will be, sold or exited, including businesses that have been placed in wind down status that do not qualify for "discontinued operations" accounting treatment under U.S. GAAP. We exclude these results from our adjusted operating income. See Note 22 to the Consolidated Financial Statements for an explanation of adjusted operating income.

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

Other. In addition to the business described above, the results of Divested Businesses also include the following:

- In 2008, we announced our intention to exit our financial advisory business, which consisted of our investment in a retail securities brokerage and clearing operations joint venture which was sold on December 31, 2009. Certain expenses relating to the businesses we originally contributed to the joint venture were retained, primarily for litigation and regulatory matters.
- In 2003, we sold our property and casualty insurance companies to Liberty Mutual Group ("Liberty Mutual"). We have reinsured Liberty Mutual for adverse loss development for specific property and casualty risks that they did not want to retain. We believe that we have adequately reserved for our remaining property and casualty obligations under these reinsurance contracts based on the current information available.
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We ceased writing individual disability income policies in 1992, and a year later ceased writing hospital expense and major medical policies. Most of our individual disability income policies are non-cancelable; however, we reinsured all of these policies as of July 1999. For our hospital expense and major medical policies, the 1996 Health Insurance Portability and Accountability Act guarantees renewal beyond age 65. Under certain circumstances, with appropriate approvals from state regulatory authorities, we are permitted to change the premiums charged for these policies if we can demonstrate the premiums have not been sufficient to pay claims. We establish reserves in accordance with U.S. GAAP for future policyholder benefits and expenses.

- We have not actively engaged in the assumed life reinsurance market in the United States since the early 1990s; however, we remain subject to mortality risk for certain assumed individual life insurance policies under the terms of the reinsurance treaties. We establish reserves in accordance with U.S. GAAP for future policyholder benefits and expenses.

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Closed Block Division

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

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

As discussed in Note 12 to the Consolidated Financial Statements, if the performance of the Closed Block is more or less favorable than we originally assumed in funding, total dividends paid to Closed Block policyholders in the future may be greater or less than the total dividends that would have been paid to these policyholders if the policyholder dividend scales in effect in 2000 had been continued. Any experience in excess of amounts assumed may be available for distribution over time to Closed Block policyholders as part of policyholder dividends unless offset by future Closed Block experience that is less favorable than expected. This excess experience will not be available to shareholders. A policyholder dividend obligation liability is established for any excess experience. Each year, the Board of Directors of Prudential Insurance determines the dividends payable on participating policies for the following year based on the experience of the Closed Block, including investment income, net realized and unrealized investment gains, mortality experience and other factors. See Note 22 to the Consolidated Financial Statements for revenues, income and loss, and total assets of the Closed Block division.

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

Prudential Insurance reinsures substantially all of the outstanding liabilities of the Closed Block into a statutory guaranteed separate account of a wholly-owned subsidiary, Prudential Legacy Insurance Company of New Jersey (“PLIC”), primarily on a coinsurance basis.

Intangible and Intellectual Property

We capture and protect the innovation in our financial services products by applying for federal business method patents and implementing trade secret controls, as appropriate. We also use numerous federal, state, common law and foreign servicemarks, including in particular “Prudential”, “Prudential Financial”, the “Prudential logo” and our “Rock” symbol. We believe that the value associated with many of our patents and trade secrets, and the goodwill associated with many of our servicemarks are significant competitive assets.

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

Regulation

Overview

Our businesses are subject to comprehensive regulation and supervision. The purpose of these regulations is primarily to protect our customers and the overall financial system and not necessarily our shareholders or debt holders. Many of the laws and regulations to which we are subject are regularly re-examined. Existing or future laws and regulations may become more restrictive or otherwise adversely affect our operations or profitability, increase compliance costs, or increase potential regulatory exposure. In recent years we have experienced, and expect to continue to experience, extensive changes in the laws and regulations, and

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regulatory frameworks applicable to our businesses in the U.S. and internationally, including the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") discussed below. In addition, we cannot predict how current or future initiatives will impact these existing laws, regulations and regulatory frameworks.

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

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

- Dodd-Frank Wall Street Reform and Consumer Protection Act
- ERISA and DOL Fiduciary Rules
- U.S. State Insurance Holding Company Regulation
- U.S. Insurance Operations
  - State Insurance Regulation
  - U.S. Federal and State Securities Regulation Affecting Insurance Operations
- International Insurance Regulation
- U.S. Investment and Retirement Products and Investment Management Operations
- U.S. Securities and Commodity Operations
- International Regulation of Non-Insurance Operations
- Derivatives Regulation
- Privacy and Cybersecurity Regulation
- Anti-Money Laundering and Anti-Bribery Laws
- Environmental Laws and Regulations
- Unclaimed Property Laws
- Taxation
  - U.S. Taxation
  - International Taxation
- International and Global Regulatory Initiatives

Several of our domestic and foreign regulators, including the Board of Governors of the Federal Reserve System ("FRB") and the New Jersey Department of Banking and Insurance ("NJDOBI"), participate in an annual supervisory college. The purpose of the supervisory college is to promote ongoing supervisory coordination, facilitate the sharing of information among regulators and to enhance each regulator's understanding of the Company's risk profile. The most recent supervisory college was held in October 2017.

Dodd-Frank Wall Street Reform and Consumer Protection Act

Dodd-Frank subjects us to substantial federal regulation, primarily as a non-bank financial company (a "Designated Financial Company") designated for supervision by the FRB, as discussed below. We cannot predict the timing or requirements of the regulations not yet adopted under Dodd-Frank or how such regulations will impact our business, credit or financial strength ratings, results of operations, cash flows, financial condition or competitive position. Furthermore, we cannot predict whether such regulations will make it advisable or require us to hold or raise additional capital or liquid assets, potentially affecting capital deployment activities, including buying back shares or paying dividends.

Initiatives Regarding Dodd-Frank and Financial Regulation

In November 2017, the U.S. Department of the Treasury released a report titled "Financial Stability Oversight Council Designations," with recommendations on the Financial Stability Oversight Council's (the "Council") standards and processes for the designation and continued designation of Designated Financial Companies. The Treasury was directed by President Trump in

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an April 2017 memorandum to review the process and issue the report. The report recommends, among other things, prioritizing an activities-based approach over the use of individual company designations, enhancing coordination and engagement with primary insurance regulators at the state level, and improving the analysis used to support determinations.

In October 2017, the U.S. Department of the Treasury released a report titled “A Financial System That Creates Economic Opportunities - Asset Management and Insurance.” The Treasury was directed by President Trump in a February 2017 executive order to review the regulation of the financial system and issue the report. The report identifies laws, regulations and other requirements that promote or inhibit certain core principles of financial regulation that are outlined in the order. Among other things, the report recommends that primary federal and state regulators should focus on potential systemic risks arising from products and activities, and on implementing regulations that strengthen the asset management and insurance industries as a whole, rather than focus on an entity-based regulatory regime. The report also affirms the role of the U.S. state-based system of insurance regulation. In addition, the report supports current efforts at the DOL to reexamine, and delay full implementation of, the fiduciary rules, and encourages the DOL and the U.S. Securities and Exchange Commission (“SEC”) to work with state insurance regulators to evaluate the impacts of the fiduciary rules across markets.

In June 2017, the U.S. House of Representatives passed the Financial CHOICE Act, which, if enacted, would amend certain provisions of Dodd-Frank, including the authority of the Council to designate non-bank financial companies for enhanced supervision by the FRB. In addition, from time to time other legislation aimed at limiting Dodd-Frank has been proposed.

We cannot predict whether the Treasury reports, the Financial CHOICE Act or other initiatives aimed at revising Dodd-Frank and regulation of the financial system will ultimately form the basis for changes to laws or regulations impacting the Company, or lead to the removal of the Company’s Designated Financial Company status.

Regulation as a Designated Financial Company

Dodd-Frank established the Council, which is authorized to subject non-bank financial companies such as Prudential Financial to stricter prudential standards and to supervision by the FRB if the Council determines that either (i) material financial distress at the Company, or (ii) the nature, scope, size, scale, concentration, interconnectedness, or mix of the Company’s activities, could pose a threat to domestic financial stability. Prudential Financial has been a Designated Financial Company since September 2013 under the first criterion. Under Dodd-Frank the Council is required to reevaluate this designation at least annually. The Council last voted to maintain Prudential Financial’s designation in December 2015, and our designation is currently being reevaluated.

Thus far the FRB has focused its general supervisory authority over us in several areas, including oversight of our capital planning and risk management processes, model governance and validation, liquidity management, compliance, information and technology security, and resolution and recovery planning.

As a Designated Financial Company, the Company is, or may become, subject to the following standards (many of which are the subject of ongoing rule-making as described below), among others:

- Capital, leverage and liquidity requirements. Dodd-Frank requires the FRB to establish requirements and limitations relating to capital, leverage and liquidity. The FRB issued an advance notice of proposed rulemaking in June 2016 regarding approaches to minimum regulatory capital requirements, but otherwise has taken no public action.
- Corporate governance, risk management and liquidity risk requirements. The FRB issued a proposed rule in June 2016 that would apply consistent liquidity risk, corporate governance, and risk-management standards to Designated Financial Companies, but has not issued a final rule.

- Stress testing. Dodd-Frank requires us to be subject to stress tests to be promulgated by the FRB. Under FRB rules, Designated Financial Companies must comply with these requirements in the calendar year after the year in which a company first becomes subject to the FRB's minimum regulatory capital requirements discussed above, although the FRB has the discretion to accelerate or extend the effective date.
- Early remediation. The FRB is required under Dodd-Frank to prescribe regulations for the establishment of an "early remediation" regime for the financial distress of Designated Financial Companies.
- Resolution planning. We are required to submit to the FRB and Federal Deposit Insurance Corporation ("FDIC"), and periodically update in the event of material events, a plan for rapid and orderly resolution in the event of severe financial distress. We submitted our last resolution plan in December 2015. In July 2017, the FRB and the FDIC announced that the next resolution plan filing deadline will be delayed from December 31, 2017 to December 31, 2018. If the FRB and the FDIC were to jointly determine that our 2015 resolution plan, or any future resolution plan, is not credible or would not facilitate an orderly resolution of the Company under applicable law, and the Company is unable to remedy the identified deficiencies in a timely manner, the regulators may jointly impose more stringent capital, leverage or liquidity requirements or restrictions on growth, activities or operations, or require us

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to divest assets. The FRB and FDIC have thus far issued no comments on our 2015 resolution plan.

- Recovery planning. We are also required to submit to the FRB a recovery plan that describes the steps that the Company could take to reduce risk and conserve or restore liquidity and capital in the event of severe financial stress scenarios. We submitted our first recovery plan in 2016. We are scheduled to submit our next recovery plan in June 2019.
- Credit exposure limits. Dodd-Frank requires the FRB to promulgate regulations that would prohibit Designated Financial Companies from having a credit exposure to any unaffiliated company in excess of 25% of the Designated Financial Company's capital stock and surplus. The FRB has not proposed any such rule.
- Acquisitions. As a Designated Financial Company, we must seek pre-approval from the FRB for the acquisition of specified interests in certain companies engaged in financial activities.
- Recommendations to other regulators. The Council may recommend that state insurance regulators or other regulators apply new or heightened standards and safeguards for activities or practices we and other insurers or other financial services companies engage in.
- Activities based capital requirements. As a Designated Financial Company, we could be subject to additional capital requirements for, and other restrictions on, proprietary trading and sponsorship of, and investment in, hedge, private equity and other covered funds.

ERISA and DOL Fiduciary Rules

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

DOL Fiduciary Rules and Other Fiduciary Rules Developments

In April 2016, the DOL issued a final regulation accompanied by new class exemptions and amendments to long-standing exemptions from the prohibited transaction provisions under ERISA (collectively, the "Rules"). The Rules redefine who is considered a "fiduciary" for purposes of transactions with qualified plans, plan participants and Individual Retirement Accounts ("IRAs"), and generally provide that investment advice to a plan participant or IRA owner will be treated as a fiduciary activity. The Rules became applicable, in part, on June 9, 2017 and the remainder of the Rules will become applicable on July 1, 2019. In November 2017, the DOL announced an 18-month extension of the previous January 1, 2018 applicability date for the remainder of the Rules in order to give the DOL the time necessary to consider public comments received in response to a DOL request for information (as further described below), including whether changes and alternatives to the Rules would be appropriate.

In February 2017, President Trump directed the DOL to examine the Rules to determine whether they may adversely affect access to retirement information and advice and, if so, to issue a proposed rule rescinding or revising the Rules. In connection with the ongoing examination of the Rules as directed by President Trump, the DOL issued a request for information seeking public comment on the Rules. In addition, the Secretary of Labor has stated that he will seek to engage with the SEC on the Rules. In June 2017, the Chairman of the SEC issued a public statement soliciting comments on the standard of conduct for investment advisers and broker-dealers when they provide advice to retail investors. The National Association of Insurance Commissioners (“NAIC”) has also formed an Annuity Suitability Working Group, which is considering the development of enhanced standards for the sale of annuities. In addition, in December 2017, the New York State Department of Financial Services (“NY DFS”) proposed amendments to its suitability regulations which, if enacted, would impose a best-interest standard to the sale of all annuity and life insurance products in New York, and other state regulators and legislatures have adopted or are considering adopting best interest standards. We cannot predict what impact these developments will have on the Rules and their application to our products or on the standard of conduct applicable to some of our businesses.

We believe the Rules primarily impact our Individual Annuities, Retirement and Investment Management segments and our Prudential Advisors distribution system, which we include in the results of our Individual Life segment. Overall, the Rules have resulted in increased compliance costs and may create increased exposure to legal claims under certain circumstances, including class actions. In addition, we have experienced a decline in sales in our annuities business, which may continue. Significant aspects of the Rules and their impact on our businesses include the following:

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• Prudential Advisors. We have taken the steps we believe are necessary to comply with the part of the Rules currently in effect which pertains to the “best interest contract exemption” for investment advice concerning retirement plans and IRAs, including recommendations to purchase products sold to IRAs, which constitutes a significant part of Prudential Advisors’ non-life insurance new business revenues. The Rules have also resulted in changes to compensation and benefit structures, and our product offerings. The Rules impose compliance requirements and may result in damages and liability under ERISA and the Internal Revenue Code for excise taxes, disgorgement of profit, and other possible remedies. Unless revised, one of the parts of the Rules scheduled to become applicable in 2019 requires a financial institution, if it wishes to rely on the best interest contract exemption in the Rules, to enter into a contract with each customer to whom “investment advice” is given. This contract must provide, among other things, for a new private right of action that may result in additional damages and liability.

•Annuities. In response to the Rules becoming effective, certain distributors restricted the sale of certain types of annuities. During the delay of certain requirements until July 2019, all qualified sales of variable and fixed annuities are generally subject to the same “impartial conduct standards” under the Rules. If the Rules become effective in their current form, following the July 2019 effective date, sales of variable annuities by our retail distributors, including Prudential Advisors, would only be permitted pursuant to the best interest contract exemption described above, while sales of certain fixed annuities would be permitted pursuant to the best interest contract exemption or a separate exemption. In addition, in some instances we are altering our product design, offerings or pricing to meet the needs of certain distributors to support their compliance with the Rules. We are also monitoring and limiting certain wholesaling and other sales support and customer service activities to continue not to be classified as a fiduciary under the Rules.

•Retirement. We have made certain changes to the asset allocation tools available for use by participants in defined contribution plans, which may include illustrations based on specific investments, so that the tools should not fall within the definition of acting as a fiduciary for plan clients. We have instituted processes for IRA offerings to comply with the new best interest contract exemption referred to above in connection with recommendations to plan participants to roll assets over to an IRA or retain them in their employer’s retirement plan. In addition, we have taken certain actions with sponsors and intermediaries for plans with less than $50 million in assets to continue not to be classified as a fiduciary under the Rules. Historically, the substantial majority of our earnings in the Retirement business have not come from IRA offerings, asset retention and consolidation activities, and plans with less than $50 million in assets.

•Investment Management. In some instances we have altered our product design, offerings or pricing in order to meet the needs of certain distributors of mutual funds to support their compliance with the Rules. We are also monitoring and limiting certain wholesaling and other sales support and customer service activities to continue not be classified as a fiduciary under the Rules.

The Rules have had an impact on our business as described above, and any revised Rules or additional standards developed by the DOL, the SEC or the NAIC and state regulators may further affect our business, results of operations, cash flows and financial condition.

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

U.S. State Insurance Holding Company Regulation

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

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

Group-Wide Supervision

NJDOBI has acted as the group-wide supervisor of Prudential Financial since 2015 pursuant to New Jersey legislation that authorizes group-wide supervision of internationally active insurance groups. The law, among other provisions, authorizes NJDOBI to examine Prudential Financial and its subsidiaries, including by ascertaining the financial condition of the insurance companies for purposes of assessing enterprise risk. In accordance with this authority, NJDOBI receives information about the Company's operations beyond those of its New Jersey domiciled insurance subsidiaries.

The NAIC has promulgated model laws for adoption in the United States that would provide for group-wide supervision of certain insurance holding companies in addition to the current regulation of insurance subsidiaries. While the timing of their adoption and content will vary by jurisdiction, we have identified the following areas of focus in these model laws: (1) uniform standards for insurer corporate governance; (2) group-wide supervision of insurance holding companies; (3) adjustments to risk-based capital calculations to account for group-wide risks; and (4) additional regulatory and disclosure requirements for insurance holding companies.

Some laws which facilitate group-wide supervision have already been enacted in the jurisdictions in which we operate, such as Own Risk and Solvency Assessment ("ORSA") reporting, which requires larger insurers to assess the adequacy of its and its group's risk management and current and future solvency position, and Corporate Governance Annual Disclosure reporting, which requires us to report on our governance structure, policies and practices.

The NAIC has formed a working group to develop a U.S. group capital calculation using an RBC aggregation methodology. In constructing the calculation the working group is considering group capital developments undertaken by the FRB and the International Association of Insurance Supervisors ("IAIS").

The NAIC has also established a new initiative to develop a macroprudential framework intended to: (1) improve state insurance regulators' ability to monitor and respond to the impact of external financial and economic risks on insurers; (2) better monitor and respond to risk emanating from or amplified by insurers that might be transmitted externally; and (3) increase public awareness of NAIC/state monitoring capabilities regarding macroprudential trends. As part of this initiative, the areas identified by the NAIC for potential enhancement include liquidity, resolution and recovery, capital stress testing, and counterparty exposure and concentration. We cannot predict what, if any, additional requirements and compliance costs any new group-wide standards will impose on Prudential Financial.

State insurance departments conduct periodic examinations of the books and records, financial reporting, policy filings and market conduct of insurance companies domiciled in their states, generally once every three to five years.

Examinations are generally carried out in cooperation with the insurance departments of other states under guidelines promulgated by the NAIC. During 2016, as part of the normal five year examination, NJDOBI, along with the insurance regulators of Arizona, Connecticut and Indiana commenced a coordinated risk-focused financial examination for the five year period ended December 31, 2016, covering Prudential and all of its subsidiaries in connection with NJDOBI’s role as group-wide supervisor. We expect the exam to be completed in 2018.

U.S. Insurance Operations

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

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by federal and state tax laws.

State Insurance Regulation

State insurance authorities have broad administrative powers with respect to all aspects of the insurance business including: (1) licensing to transact business; (2) licensing agents; (3) admittance of assets to statutory surplus; (4) regulating premium rates for certain insurance products; (5) approving policy forms; (6) regulating unfair trade and claims practices; (7) establishing reserve requirements and solvency standards; (8) fixing maximum interest rates on life insurance policy loans and minimum accumulation or surrender values; (9) regulating the type, amounts and valuations of investments permitted; (10) regulating reinsurance transactions, including the role of captive reinsurers; and (11) other matters.

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

Financial Regulation

Dividend Payment Limitations. New Jersey insurance law and the insurance laws of the other states in which our insurance companies are domiciled regulate the amount of dividends that may be paid by Prudential Insurance and our other U.S. insurance companies. See Note 15 to the Consolidated Financial Statements for additional information.

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

The NAIC's Investment Risk-Based Capital Working Group is developing updates to the RBC factors for invested assets including expanding, for RBC purposes, the current NAIC designations from six to twenty. Additional adjustments to the RBC calculation are also under consideration by the NAIC, including new charges for longevity risk and operational risk. Due to the ongoing nature of the NAIC's activities regarding RBC, we cannot determine the ultimate timing of these changes or their impact on RBC or on our financial position.

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

In June 2016, the NAIC adopted a recommendation that will activate a principles-based reserving approach for life insurance products. Principles-based reserving replaces the reserving methods for life insurance products for which the current formulaic basis for reserves may not accurately reflect the risks or costs of the liability or obligations of the insurer. The principles-based reserving approach has a three-year phase-in period. At the Company's discretion, it may be applied to new individual life business beginning as early as January 1, 2017, but must be applied for all new individual life business issued January 1, 2020 and later. The Company may select different implementation dates for different products. Principles-based reserving will not affect reserves for policies in force prior to January 1, 2017.

During 2017, the Company adopted principles-based reserving for its guaranteed universal life products and introduced updated versions of these products that are expected to support the principles-based statutory reserve level without the need for captive reserve financing or additional assets under Actuarial Guideline No. 48 (“AG 48”). AG 48 prescribes an actuarial method to determine the portion of the assets held to support reserves for certain term and universal life policies that must be cash and rated securities, and the portion that may be financed or supported by other assets. The Credit for Reinsurance Model Law and the Term and Universal Life Insurance Reserving Financing Model Regulation, which are consistent with AG 48, will replace AG 48 in a state upon the state’s adoption of the model law and regulation. The Company is continuing to assess the impact of this new reserving approach on projected statutory reserve levels and product pricing for its remaining portfolio of individual life product offerings, such as term and variable life insurance.

As a result of an agreement with the NY DFS regarding our reserving methodologies for certain variable annuity and life insurance products, certain of our New York licensed insurance subsidiaries hold additional statutory reserves on a New York

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basis, which reduces their New York statutory surplus. None of our U.S. operating insurance companies are domiciled in New York, and these changes do not impact statutory reserves reported in our insurance subsidiaries' states of domicile, or any states other than New York, and therefore do not impact RBC ratios; however, the agreed reserve methodologies may require us to hold additional New York statutory reserves in the future. If we were required to establish material additional reserves on a New York statutory accounting basis or post material amounts of additional collateral with respect to annuity or insurance products, our ability to deploy capital held within our U.S. domestic insurance subsidiaries for other purposes could be affected.

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

Variable Annuities. In November 2015, the NAIC adopted the Variable Annuities Framework for Change, which outlines the NAIC's commitment to change in concept the statutory framework to address concerns that have led to the development and utilization of captive reinsurance transactions for variable annuity business in order to create more consistency across regulators and remove the impetus for insurers to cede risk to captives. The framework contemplates extensive changes to the guidance and rules governing variable annuities, including with regard to reserving, capital, accounting, derivative use limitations and disclosure.

In December 2017, the NAIC exposed for public comment proposed recommendations and revisions to the current Actuarial Guideline No. 43 ("AG 43") and RBC "C-3 Phase II" framework applicable to variable annuities reserve and capital requirements. Proposed changes include: (i) aligning economically-focused hedge assets with liability valuations; (ii) reforming standard scenarios for AG 43 and C3 Phase II; (iii) revising asset admissibility for derivatives and deferred tax assets; and (iv) standardizing capital market assumptions and aligning total asset requirements and reserves. Given the uncertainty of the ultimate outcome of these initiatives, at this time we are unable to predict the timing of any new rules or their expected effects on our business. If applicable insurance laws are changed in a way that impairs our ability to write variable annuities and efficiently manage their associated risks, we may need to increase prices or modify our products, which could also adversely affect our competitiveness, capital and financial position and results of operations.

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

Market Conduct Regulation

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

Insurance Guaranty Association Assessments

Each state has insurance guaranty association laws under which insurers doing business in the state are members and may be assessed by state insurance guaranty associations for certain obligations of insolvent insurance companies to policyholders and claimants. Typically, states assess each member insurer in an amount related to the member insurer’s proportionate share of the line of business written by all member insurers in the state. Many states offer a reimbursement of such assessments in the form of credits against future years’ premium taxes. For the years ended December 31, 2017, 2016 and 2015, we paid $12.6 million, $1.5 million and $0.6 million, respectively, in assessments pursuant to state insurance guaranty association laws. The 2017 assessments reflected the Penn Treaty Network America Insurance Company insolvency, which was liquidated on March 1, 2017. While we cannot predict the amount and timing of future assessments on our U.S. insurance companies under these laws, we have established estimated reserves totaling approximately $35.4 million as of December 31, 2017, for future assessments relating to insurance companies that are currently subject to insolvency proceedings including Penn Treaty Network America Insurance Company, Executive Life of California and Lincoln Memorial Life Insurance Company.

In 2017, the NAIC approved amendments to the Life and Health Insurance Guaranty Association Model Act to address issues relating to long-term care insurance-related insolvencies. The amendments will spread costs from future long-term care

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insurance-related insolvencies across the entire health and life insurance industry, resulting in increased assessments for life insurers. The amended model law will become applicable to us as it is adopted by each state. Prior insolvencies will not be included under these amendments. Given our current market share of the impacted lines of business, we expect our cost related to future insolvencies, net of premium tax credits available under current state laws, would be a small percentage of the gross industry liability.

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

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

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

Federal Insurance Office

Dodd-Frank established a Federal Insurance Office ("FIO") within the Department of the Treasury headed by a director appointed by the Secretary of the Treasury. While the FIO does not have general supervisory or regulatory authority over the business of insurance, the FIO director performs various functions with respect to insurance, including serving as a non-voting member of the Council, monitoring the insurance sector and representing the U.S. on prudential aspects of international insurance matters, including at the IAIS.

International Insurance Regulation

Our international insurance operations are principally supervised by regulatory authorities in the jurisdictions in which they operate, including the Japanese Ministry of Finance and the Japanese FSA, the financial services regulator in Japan. In addition to Japan, we operate insurance companies in Korea, Taiwan, Mexico, Argentina, Brazil, Italy and Poland and have insurance operations in China, India, Indonesia and Malaysia through joint ventures, and in Ghana through a strategic investment. The insurance regulatory bodies for these businesses typically oversee such issues as: (1) company licensing, (2) the licensing of insurance sales staff; (3) insurance product approvals; (4) sales practices; (5) claims payment practices; (6) permissible investments; (7) solvency and capital adequacy; and (8) insurance reserves, among other items. In some jurisdictions, for certain products, regulators will also mandate premium rates (or components of pricing) or minimum guaranteed interest rates. Periodic examinations of insurance company books and records, financial reporting requirements, market conduct examinations and policy filing requirements are among the techniques used by these regulators to supervise our non-U.S. insurance businesses. Finally, insurance regulatory authorities in the various jurisdictions in which our insurance companies are domiciled, including Japan, must approve any change of control of Prudential Financial or the insurance companies organized under their laws.

Solvency Regulation

In order to monitor insurers' solvency, regulatory authorities in the jurisdictions in which we operate outside the U.S. generally establish some form of minimum solvency requirements for insurance companies, similar in concept to the

RBC ratios that are employed by U.S. insurance regulators. These solvency ratios are used by regulators to assess the sufficiency of an insurer's capital and claims-paying ability and include the impact of transactions with affiliated entities. Certain jurisdictions require the disclosure of solvency ratios to the public. Insurers that have lower solvency ratios than the regulators require are considered to have inadequate capital and are subject to varying degrees of regulatory action depending upon the level of capital inadequacy.

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

Japan Capital and Solvency Regulation. Our Japan insurance operations are subject to a consolidated basis capital standard known as the Solvency Margin Ratio framework ("SMR"). This standard prescribes the manner in which an insurance company's capital is calculated and is meant to respond to changes in financial markets, improve risk management practices of insurers and

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consider risks associated with the insurer's subsidiaries. In 2016, the FSA conducted a field test of a potential market based alternative to the SMR framework that closely aligned with components of the IAIS's risk-based Global Insurance Capital Standard ("ICS"), which is described below under "—Other International and Global Regulatory Initiatives." The FSA may continue to explore potential alternatives or revisions to the existing SMR framework. We cannot predict whether changes to the SMR will be adopted, or if they will result in additional capital requirements and compliance costs.

Korea Accounting Standards, Capital and Solvency Regulation. In 2017, the International Accounting Standards Board ("IASB") released a new International Financial Reporting Standard ("IFRS") for accounting for insurance contracts that will go into effect in 2021 in Korea and in certain other jurisdictions where we operate. Korea's Financial Supervisory Service and Financial Services Commission announced plans to enhance the liability adequacy test in June 2017 as part of its adoption effort. The enhancements require life insurers to set aside additional policy reserves in phases from December 2017 to 2020 to support the transition to IFRS, which is expected to lead to an increase in the level of reserves insurers must hold. In Japan, changes in IFRS do not currently impact our operations as they are not required to report under IFRS.

Our Korea insurance operation is subject to RBC requirements that are based in part on financial statements prepared in accordance with current accounting requirements. In 2017, the Financial Supervisory Service ("FSS") of Korea conducted a field test of a potential market based alternative to the RBC framework that closely aligned with components of the IAIS' ICS, which is described below under "—Other International and Global Regulatory Initiatives." The FSS will continue to explore potential alternatives or revisions to the existing RBC framework through further quantitative impact studies with the intention of implementing changes in 2021. We cannot predict whether changes to the RBC framework will ultimately be adopted, or if they will result in additional capital requirements and compliance costs.

Dividend Payment Limitations

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

Insurance Guaranty Fund Assessments

Certain of our international insurance operations, including those in Japan, may be subject to assessments, generally based on their proportionate share of business written in the relevant jurisdiction, for certain obligations of insolvent insurance companies to policyholders and claimants. As we cannot predict the timing of future assessments, they may materially affect the results of operations of our international insurance operations in particular quarterly or annual periods. Under the Japanese insurance guaranty law, all licensed life insurers in Japan are required to be members of and are assessed, on a pre-funded basis, by the Japan Policyholders Protection Corporation ("PPC"). These assessments generate a collective fund which is used to satisfy certain obligations of insolvent insurance companies to policyholders and claimants. The PPC assesses each member in an amount related to its proportionate share of new business written by all member insurers. For the years ended December 31, 2017, 2016 and 2015, we paid approximately $21 million, $22 million and $23 million, respectively, based on fixed currency exchange rates, in assessments pursuant to Japanese insurance guaranty association laws.

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

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

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

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

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

U.S. Securities and Commodity Operations

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

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

International Regulation of Non-Insurance Operations

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

In June 2016, the U.K. approved a non-binding referendum to exit the European Union. The formal process for the U.K. to exit from the European Union remains subject to ongoing negotiation between the U.K. and the European Union on the timing and terms of the exit. The outcome of the negotiations will determine the ultimate impact of the exit on our operations and investments in those jurisdictions and may lead to volatility in currency exchange rates and asset prices, as well as changes in regulation.

Derivatives Regulation

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

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

Privacy and Cybersecurity Regulation

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

- provide additional protections regarding the use and disclosure of certain information such as social security numbers;
- require notice to affected individuals, regulators and others if there is a breach of the security of certain personal information;
- require financial institutions and creditors to implement effective programs to detect, prevent, and mitigate identity theft;
- regulate the process by which financial institutions make telemarketing calls and send e-mail or fax messages to consumers and customers; and
- prescribe the permissible uses of certain personal information, including customer information and consumer report information.

Financial regulators in the U.S. and international jurisdictions in which we operate continue to focus on cybersecurity, including in proposed rulemaking, and have communicated heightened expectations and have increased emphasis in this area in their examinations of regulated entities. For example, the European Union’s General Data Protection Regulation, which is scheduled to become effective in May 2018, confers additional privacy rights on individuals in the European Union and establishes penalties for violations. In addition, legislative and regulatory bodies may consider additional or more detailed or restrictive laws and regulations regarding these subjects and the privacy and security of personal information.

In March 2017, the NY DFS’s new cybersecurity regulation went into effect. The regulation requires financial institutions regulated by NY DFS, including our insurance subsidiaries licensed in New York, to establish a cybersecurity program. The regulation includes specific technical safeguards as well as requirements regarding governance, incident planning, data management, system testing, vendor oversight and regulator notification. In addition, in October 2017, the NAIC adopted the Insurance Data Security Model Law that is consistent with the New York regulation. The model law in turn is expected to form the basis for legislation in the other states in which our insurers operate.

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

Anti-Money Laundering and Anti-Bribery Laws

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

Environmental Laws and Regulations

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

Unclaimed Property Laws

We are subject to the laws and regulations of states and other jurisdictions concerning the identification, reporting and escheatment of unclaimed or abandoned funds, and we are subject to audit and examination for compliance with these requirements. For additional discussion of these matters, see Note 23 to the Consolidated Financial Statements.

Taxation

U.S. Taxation

The Company and certain domestic subsidiaries file a consolidated federal income tax return that includes both life insurance companies and non-life insurance companies. Certain other domestic subsidiaries file separate tax returns. The principal differences between the Company's actual income tax expense and the applicable statutory federal income tax rate are generally deductions for non-taxable investment income, including the dividends received deduction ("DRD"), foreign taxes applied at a different tax rate than the U.S. rate and certain tax credits. For tax years prior to 2018, the applicable statutory federal tax rate was 35%. For tax years starting in 2018, the applicable statutory federal income tax rate is 21%. In addition, as discussed further below, the tax attributes of our products may impact both the Company's and our customers' tax positions. See "Income Taxes" in Note 2 to the Consolidated Financial Statements and Note 19 to the Consolidated Financial Statements for a description of the Company's tax position. As discussed further below, new tax legislation and other potential changes to the tax law may impact the Company's tax position and the attractiveness of our products.

H.R.1, also referred to as the Tax Cuts and Jobs Act of 2017 (the "Tax Act of 2017"), was enacted into law on December 22, 2017 and is generally effective starting in 2018. The Tax Act of 2017 changes the taxation of businesses and individuals by lowering tax rates and broadening the tax base through the acceleration of taxable income and the deferral or elimination of certain deductions, as well as changing the system of taxation of earnings of foreign subsidiaries. The most significant changes for the Company are: (1) the reduction of the corporate tax rate from 35% to 21%; (2) revised methodologies for determining deductions for tax reserves and the DRD; (3) an increased capitalization and amortization period for acquisition costs related to certain products; (4) the change from a worldwide to a modified territorial system of taxation on applicable earnings of foreign subsidiaries; (5) a new tax on earnings of foreign subsidiaries (the Global Intangible Low-Taxed Income provision ("GILTI")); and (6) a new tax with respect to payments to non-U.S. affiliates that are at least 25% owned (the Base Erosion Anti-Abuse Tax ("BEAT")).

Our analysis of the Tax Act of 2017 is ongoing, as guidance may be needed from the Treasury Department and the Internal Revenue Service ("IRS") to fully understand and implement several provisions. Other life insurance and financial services companies may benefit more or less from these tax law changes, which could impact the Company's overall competitive position. The law is also expected to reduce the Company's domestic statutory capital and risk-based capital. For additional details, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Capital—Insurance Regulatory Capital." Notwithstanding the enactment of the Tax Act of 2017, the President, Congress, as well as state and local governments, may continue to consider from time to time legislation that could increase the amount of corporate taxes we pay, thereby reducing earnings.

U.S. federal tax law generally permits tax deferral on the inside build-up of investment value of certain retirement savings, annuities and life insurance products until there is a contract distribution and, in general, excludes from taxation the death benefit paid under a life insurance contract. The Tax Act of 2017 did not change these rules, though it is possible that some individuals with overall lower effective tax rates could be less attracted to the tax deferral aspect of the Company’s products. The general reduction in individual tax rates and elimination of certain individual deductions may also impact the Company depending on whether current and potential customers have more or less after-tax income to save for retirement and manage their mortality and longevity risk through the purchase of the Company’s products. Congress from time to time may enact other changes to the tax law that could make our products less attractive to consumers, including legislation that would modify the tax favored treatment of retirement savings, life insurance and annuities products.

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

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The level of profitability of certain products is significantly dependent on these characteristics and our ability to continue to generate taxable income, which is taken into consideration when pricing products and is a component of our capital management strategies. Accordingly, changes in tax law, our ability to generate taxable income, or other factors impacting the availability or value of the tax characteristics generated by our products, could impact product pricing and returns or require us to reduce our sales of these products or implement other actions that could be disruptive to our businesses.

International Taxation

Our international businesses are subject to the tax laws and regulations of the countries in which they are organized and in which they operate. Foreign governments from time to time consider legislation that could impact the amount of taxes that we pay or impact the sales of our products. Such changes could negatively impact sales of our products or reduce our profits.

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

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

International and Global Regulatory Initiatives

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

In July 2013, we along with eight other global insurers, were designated by the FSB as a global systemically important insurer (“G-SII”) through a quantitative methodology developed and implemented by the IAIS. Similar assessments were performed and subsequent G-SII designation lists were issued annually through November 2016. We remained designated as a G-SII throughout this period. In November 2017, the FSB announced that the list of G-SIIs identified in 2016 would stand until further consideration in November 2018. The FSB also recommended that the IAIS continue ongoing efforts to develop an activities-based approach to assessing and managing potential systemic risk in the insurance sector.

At the direction of the FSB, the IAIS has developed a set of group level policy measures for insurance supervisors to apply to G-SIIs, including two group-wide capital standards. The basic capital requirement (“BCR”), which was approved by the FSB and G20 in November 2014, is a globally consistent and comparable baseline capital metric. The higher loss absorbency ("HLA") standard, which was approved by the FSB and G20 in November 2015, establishes a capital buffer to be held in addition to the BCR. In February 2017, the IAIS, with the approval of the FSB, delayed jurisdictional implementation of HLA until 2022 at the earliest and advised that the ICS would replace the BCR as the foundation for the HLA requirement.

In addition to G-SII related policy measures, the IAIS is developing the Common Framework for the Supervision of Internationally Active Insurance Groups ("ComFrame"). Through ComFrame, the IAIS seeks to promote effective and globally consistent supervision of the insurance industry through uniform standards for insurer corporate governance, enterprise risk management and other control functions, group-wide supervision and group capital adequacy. The non-capital related components of ComFrame are being developed iteratively through a series of public consultations and are scheduled to be adopted by the IAIS in 2019. The ICS, which is the capital adequacy component of ComFrame, is also being developed iteratively through both a series of public consultations and voluntary field tests. Recently, the IAIS announced an agreement among its members on the development and implementation of the ICS. Terms of the agreement include: adoption of the ICS by the IAIS in 2019; a five-year monitoring phase beginning in 2020 during which Internationally Active Insurance Groups ("IAIGs") are to report ICS results to their group supervisory authorities; and implementation of the ICS at the jurisdictional level in 2026.

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

Employees

As of December 31, 2017, we had 49,705 employees and sales associates, including 29,334 located outside of the United States. We believe our relations with our employees and sales associates are satisfactory.

Available Information

Prudential Financial files periodic and current reports, proxy statements and other information with the SEC. Such reports, proxy statements and other information may be obtained through the SEC's website (www.sec.gov) or by visiting the Public Reference Room of the SEC at 100 F Street, N.E., Washington D.C. 20549 or calling the SEC at 1-800-SEC-0330.

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

ITEM 1A. RISK FACTORS

You should carefully consider the following risks. These risks are not exclusive, and additional risks to which we are subject include, but are not limited to, the factors mentioned under "Forward-Looking Statements" above and the risks of our businesses described elsewhere in this Annual Report on Form 10-K. Many of these risks are interrelated and could occur under similar business and economic conditions, and the occurrence of certain of them may in turn cause the emergence or exacerbate the effect of others. Such a combination could materially increase the severity of the impact of these risks on our businesses, results of operations, financial condition and liquidity.

Overview

On an annual basis, the Company reviews its risk identification framework which documents the definition, potential manifestation, and management of its risks. These Risk Factors describe the Company's material risks and their potential manifestation, as reflected in the risk identification framework. The Company's risk management framework is described under "Management's Discussion and Analysis of Financial Condition and Results of Operations—Risk Management."

The Company has categorized its risks into tactical and strategic risks. Tactical risks may cause damage to the Company, and the Company seeks to manage and mitigate them through models, metrics and the overall risk framework. The Company's tactical risks include investment, insurance, market, liquidity, and operational risk. Strategic risks can cause the Company's fundamental business model to change, either through a shift in the businesses in which it is engaged or a change in execution. The Company's strategic risks include regulatory, technological changes and other external factors. These risks, as well as the sub-risks that may impact the Company, are discussed below.

Investment Risk

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

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

Investment risk may result from (1) economic conditions, (2) adverse capital market conditions, including disruptions in individual market sectors or a lack of buyers in the marketplace, (3) volatility, (4) credit spread changes, (5) benchmark interest rate changes, (6) changes in foreign currency exchange rates and (7) declines in value of underlying collateral. These factors may impact the credit quality, liquidity and value of our investments and derivatives, potentially resulting in higher capital charges and unrealized or realized losses. Also, certain investments we hold, regardless of market conditions, are relatively illiquid and our ability to promptly sell these assets for their full value may be limited. Additionally, our valuation of investments may include methodologies, inputs and assumptions which are subject to change and different interpretation and could result in changes to investment valuations that may materially impact our results of operations or financial condition. For information about the valuation of our investments, see Note 20 to the Consolidated Financial Statements.

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

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

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

Insurance Risk

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

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

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

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

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

- Morbidity continuation is the risk that the length of time for which policyholders remain unhealthy deviates adversely from what is expected. This risk is primarily in our disability and long-term care products.

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

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

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- Lapse calamity is the risk that lapse rates over the short-term deviate adversely from what is expected. Only certain products are exposed to this risk. Products that offer a cash surrender value that resides in the general account, such as general account stable value products, could pose a potential short-term lapse calamity risk. Surrender of these products can impact liquidity, and it may be necessary in certain market conditions to sell assets to meet surrender demands. Lapse calamity can also impact our earnings through its impact on estimated future profits.
- Policyholder behavior efficiency is the risk that the behavior of our customers or policyholders deviates adversely from what is expected. Policyholder behavior efficiency risk arises through product features which provide some degree of choice or flexibility for the policyholder, which can impact the amount and/or timing of claims. Such choices include lapse, partial withdrawal, policy loan, utilization, and premium payment rates for contracts with flexible premiums. While some behavior is driven by macro factors such as market movements, policyholder behavior at a fundamental level is driven primarily by policyholders' individual needs, which may differ significantly from product to product depending on many factors including the features offered, the approach taken to market each product, and competitor pricing. For example, persistency (the probability that a policy or contract will remain in force) within our annuities business may be significantly impacted by the value of guaranteed minimum benefits contained in many of our variable annuity products being higher than current account values in light of poor market performance as well as other factors. Many of our products also provide our customers with wide flexibility with respect to the amount and timing of premium deposits and the amount and timing of withdrawals from the policy's value. Results may vary based on differences between actual and expected premium deposits and withdrawals for these products, especially if these product features are relatively new to the marketplace. The pricing of certain of our variable annuity products that contain certain living benefit guarantees is also based on assumptions about utilization rates, or the percentage of contracts that will utilize the benefit during the contract duration, including the timing of the first lifetime income withdrawal. Results may vary based on differences between actual and expected benefit utilization. Finally, surrenders of certain insurance products may increase following a downgrade of our financial strength ratings or adverse publicity. Policyholder behavior efficiency is generally a long-term risk that emerges over time. An increase in reserves due to revised assumptions has an immediate impact on our results of operations and financial condition; however, from an economic or cash flow perspective, the impact is generally long term as the excess outflow is paid over time.

Our ability to reprice products is limited, and may not compensate for deviations from our expected insurance assumptions.

Although some of our products permit us to increase premiums or adjust other charges and credits during the life of the policy or contract, the adjustments permitted under the terms of the policies or contracts may not be sufficient to maintain profitability or may cause the policies or contracts to lapse. For example, for our long-term care insurance products, our assumptions for reserves for future policy benefits have factored in an estimate of the timing and amount of anticipated and yet-to-be-filed premium increases which will require state approval. Our actual experience obtaining pricing increases could be materially different than what we have assumed, resulting in further policy liability increases which could be material. Many of our products do not permit us to increase premiums or adjust other charges and credits or limit those adjustments during the life of the policy or contract. Even if permitted under the policy or contract, we may not be able or willing to raise premiums or adjust other charges sufficiently, or at all. Accordingly, significant deviations in actual experience from our pricing assumptions could have an adverse effect on the profitability of our products. Finally, the development of a secondary market for life insurance, including life settlements or "viaticals" and investor owned life insurance, and third-party investor strategies in the annuities business, could adversely affect the profitability of existing business and our pricing assumptions for new business.

Market Risk

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Liquidity Risk

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

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

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

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

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

Operational Risk

Our operations are exposed to the risk of loss resulting from inadequate or failed processes or systems, human error or misconduct, and as a result of external events. An operational risk failure may result in one or more actual or potential impacts to the Company.

Operational Risk Types

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

Potential Impacts

- Financial losses - The Company experiences a financial loss. This loss may originate from various causes including, but not limited to, transaction processing errors and fraud.
- Customer impacts - The Company may not be able to service customers. This may result if the Company is unable to continue operations during a business continuation event or if systems are compromised due to malware or virus.

- Regulatory fines or sanctions - When the Company fails to comply with applicable laws or regulations, regulatory fines or sanctions may be imposed. In addition, possible restrictions on business activities may result.
- Legal actions - Failure to comply with laws and regulations also exposes the Company to litigation risk. This may also result in financial losses.

Liabilities we may incur as a result of operational failures are described further under “Contingent Liabilities” in Note 23 to the Consolidated Financial Statements. In addition, certain pending regulatory and litigation matters affecting us, and certain risks to our businesses presented by such matters, are discussed under “Contingent Liabilities” and “Commitments and Guarantees, Contingent Liabilities and Litigation and Regulatory Matters” in Note 23 to the Consolidated Financial Statements. We may become subject to additional regulatory and legal actions in the future.

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

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

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

We are subject to the risk that we may not adequately maintain information security. There continues to be significant and organized cyber-attack activity against western organizations, including but not limited to the financial services sector. Risks related to cyber-attack arise in the following areas:

- Protecting both “structured” and “unstructured” sensitive information is a constant need. However, some risks associated with trusted insiders (i.e., employees, consultants, or vendors who are authorized to access the Company’s systems) remain and cannot be effectively mitigated using technology alone.
- Unsuspecting employees represent a primary avenue for external parties to gain access to our network and systems. Many attacks, even from sophisticated actors, include rudimentary techniques such as coaxing an internal user to click on a malicious attachment or link to introduce malware or steal their username and password.
- In the past, hackers went after credit and debit card data, which is easy to monetize. As credit card security improves, the hackers will look to other sources of monetization, specifically personally identifiable information or using cyber-attacks or the threat of cyber-attacks to extort money from companies.
- Nation-state sponsored organizations are engaged in cyber-attacks but not necessarily for monetization purposes. Nation states appear to be motivated by the desire to gain information about foreign citizens and governments or to influence or cause disruptions in commerce or political affairs. As evidenced by the ability of criminal organizations and nation-states to successfully breach large financial institutions and the U.S. government, no organization is fully immune to cyber-attacks.
- We have also seen an increase in non-technical attempts to commit fraud or solicit information via call centers and interactive voice response systems, and we anticipate the attempts will become more common.
- We rely on third parties to provide services as described further below. While we have certain standards for all vendors that provide us services, our vendors, and in turn, their own service providers, may become subject to a security breach, including as a result of their failure to perform in accordance with contractual arrangements.

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

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

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

In addition, when our products are distributed through unaffiliated firms, we may not be able to monitor or control the manner of their distribution despite our training and compliance programs. If our products are distributed in an inappropriate manner, or to customers for whom they are unsuitable, or distributors of our products otherwise engage in misconduct, we may suffer reputational and other harm to our business. We also have a large captive distribution channel and we are subject to the risk that our monitoring and controls will not detect inappropriate sales practices or misconduct by our own agents.

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

Strategic Risk

We are subject to the risk of events that can cause our fundamental business model to change, either through a shift in the businesses in which we are engaged or a change in our execution. In addition, tactical risks may become strategic risks. For example, interest rates remaining low for a long time may, at some point, cause us to change our sales goals, exit a certain business, and/or change our business model.

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

- Our regulation as a Designated Financial Company and the associated enhanced prudential standards, many of which are subject to ongoing rule-making.
- Financial sector regulatory reform that may arise out of reports issued by the U.S. Treasury.

- Changes in tax law (including U.S. federal, state, and non-U.S.).
- The DOL fiduciary rules.
- Our regulation under U.S. state insurance laws and developments regarding group-wide supervision and capital standards, RBC factors for invested assets and reserves for life insurance, variable annuities and other products.
- Insurer capital standards in Japan, Korea and other non-U.S. jurisdictions.
- Privacy and cybersecurity regulation.

Changes in accounting rules applicable to our business may also have an adverse impact on our results of operations or financial condition. For a discussion of accounting pronouncements and their potential impact on our business, see Note 2 to the Consolidated Financial Statements.

Technological changes may be unsettling to our business model. We believe there are three aspects of technological change that would significantly impact our business model as described below. There may be other unforeseen changes in technology which may have a significant impact on our business model.

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

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

- Changes to either the policies and procedures the Company uses to locate guaranteed group annuity customers, or its reserving policies for its guaranteed group annuities, may result in increased operational expenses and complexity, and increases in reserves, which could adversely impact our results of operations and financial position. The Company’s retirement business provides guaranteed group annuity benefits under group annuity and structured settlement contracts. Under our policies and procedures, we use internal and external tools and resources to locate customers covered by our guaranteed group annuity benefits. We also have policies on the development of our reserve estimates, and we believe that we are complying with our policies and procedures and meeting our obligations to customers. The Company regularly reviews, tests and enhances the processes and tools used to locate customers, and over time, such processes and tools are expected to continue to evolve. However, in the normal course of business, at any given time there are a small number of customers covered by our guaranteed group annuity benefits that we cannot locate. In light of recent industry focus on missing retirement customers, the Company is reviewing this issue closely. Ultimately, we could see greater standardization of what may currently be divergent practices across the industry. Changes to either the policies and procedures the Company uses to locate customers, or its reserving policies, may result in increased operational expenses and complexity, and increases in reserves, which could adversely impact our results of operations and financial position.
- A downgrade in our financial strength or credit ratings could potentially, among other things, adversely impact our business prospects, results of operations, financial condition and liquidity. For a discussion of our ratings and the potential impact of a ratings downgrade on our business, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Ratings.” We cannot predict what additional actions rating agencies may take, or what actions we may take in response to the actions of rating agencies, which could adversely affect our business. Our ratings could be downgraded at any time and without notice by any rating agency. In addition, a sovereign downgrade could result in a downgrade of our subsidiaries operating in that jurisdiction, and ultimately of Prudential Financial and our other subsidiaries. For example, in September 2015, S&P downgraded Japan's sovereign rating to A+ with a 'Stable' outlook citing uncertainties around the strength of economic growth and weak fiscal positions. As a result, S&P subsequently lowered the ratings of a number of institutions in Japan, including our Japanese insurance subsidiaries. It is possible that Japan’s sovereign rating could be subject to further downgrades, which would result in further downgrades of our insurance subsidiaries in Japan. Given the importance of our operations in Japan to our overall results, such downgrades could lead to a downgrade of Prudential Financial and our domestic insurance companies.

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- London Inter-Bank Offered Rate (LIBOR) reform may adversely affect the interest rates on and value of certain derivatives and floating rate securities we hold and floating rate securities we have issued, the value and profitability of certain real estate lending and related activities conducted in our investment management business, and any other assets or liabilities whose value may be tied to LIBOR. Actions by regulators or law enforcement agencies, as well as ICE Benchmark Administration (the current administrator of LIBOR) may result in changes to the way LIBOR is determined or the establishment of alternative reference rates. For example, on July 27, 2017, the U.K. Financial Conduct Authority announced that it intends to stop persuading or compelling banks to submit LIBOR rates after 2021. The U.S. Federal Reserve, based on the recommendations of the New York Federal Reserve's Alternative Reference Rate Committee (constituted of major derivative market participants and their regulators), has announced its plans to begin publishing, in mid-2018, a Secured Overnight Funding Rate ("SOFR") which is intended to replace U.S. dollar LIBOR. Plans for alternative reference rates for other currencies have also been announced. At this time, it is not possible to predict how markets will respond to these new rates, and the effect of any changes or reforms to LIBOR or discontinuation of LIBOR on new or existing financial instruments to which we have exposure. If LIBOR ceases to exist or if the methods of calculating LIBOR change from current methods for any reason, interest rates on certain derivatives and floating rate securities we hold, securities we have issued, real estate lending and related activities we conduct in our investment management business, and any other assets or liabilities whose value is tied to LIBOR, may be adversely affected. Further, any uncertainty regarding the continued use and reliability of LIBOR as a benchmark interest rate could adversely affect the value of such instruments.
- The changing competitive landscape may adversely affect the Company. In each of our businesses we face intense competition from insurance companies, asset managers and diversified financial institutions, both for the ultimate customers for our products and, in many businesses, for distribution through non-affiliated distribution channels. Technological advances, changing customer expectations, including related to digital offerings, or other changes in the marketplace may present opportunities for new or smaller competitors without established products or distribution channels to meet consumers' increased expectations more efficiently than us. Fintech and insurtech companies have the potential to disrupt industries globally, and many participants have been partially funded by industry players. For example, in Investment Management, we expect to see continued pressure on fees given the focus on passive investment and the growth of the robo-advice channel.
- Climate Change may increase the severity and frequency of calamities, or adversely affect our investment portfolio. Climate change may increase the frequency and severity of weather related disasters and pandemics. In addition, climate change regulation may affect the prospects of companies and other entities whose securities we hold, or our willingness to continue to hold their securities. It may also impact other counterparties, including reinsurers, and affect the value of investments, including real estate investments we hold or manage for others. We cannot predict the long-term impacts on us from climate change or related regulation.
- Market conditions and other factors may adversely impact product sales or increase expenses. Examples include:
A change in market conditions, such as high inflation and high interest rates, could cause a change in consumer sentiment and behavior adversely affecting sales and persistency of our savings and protection products. Conversely, low inflation and low interest rates could cause persistency of these products to vary from that anticipated and adversely affect profitability. Similarly, changing economic conditions and unfavorable public perception of financial institutions can influence customer behavior, including increasing claims or surrenders in certain products.
Sales of our investment-based and asset management products and services may decline, and lapses and surrenders of certain insurance products and withdrawals of assets from investment products may increase if a market downturn, increased market volatility or other market conditions result in customers becoming dissatisfied with their investments or products.
Changes in our discount rate, expected rate of return, life expectancy, health care cost and assumptions regarding compensation increases for our pension and other postretirement benefit plans may result in increased expenses and reduce our profitability.
- Our reputation may be adversely impacted if any of the risks described in this section are realized. Reputational risk could manifest from any of the risks as identified in the Company's risk identification process. Failure to effectively manage risks across a broad range of risk issues exposes the Company to reputational harm. If the Company were to

suffer a significant loss in reputation, both policyholders and counterparties could seek to exit existing relationships. Additionally, large changes in credit worthiness, especially credit ratings, could impact access to funding markets while creating additional collateral requirements for existing relationships. The mismanagement of any such risks may potentially damage our reputational asset. Our business is anchored in the strength of our brand, our alignment to our values, and our proven commitment to keep our promises to our customers. Any negative public perception, founded or otherwise, can be widely and rapidly shared over social media or other means, and could cause damage to our reputation.

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ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We own our headquarters building located at 751 Broad Street, Newark, New Jersey, which comprises approximately 0.6 million square feet. Excluding our headquarters building and properties used by the International Insurance division and the international investment operations of our Investment Management segment, which are discussed below, as of December 31, 2017, we own eight and lease ten other principal properties throughout the U.S., some of which are used for home office functions. Our domestic operations also lease 178 other locations throughout the U.S.

For our International Insurance segment, as of December 31, 2017, we own seven home offices located in Japan, Korea, Taiwan, Brazil, Argentina and Malaysia, and lease four home offices located in Brazil, Italy, Mexico and Poland. We also own approximately 110 and lease approximately 530 other properties, primarily field offices, located throughout these same countries. For our Investment Management segment, which includes our international investment operations, as of December 31, 2017, we lease two home offices located in Japan and Taiwan. We also lease 12 international principal properties located in Mexico, Japan, Hong Kong, Singapore, Korea, Germany, Australia, France, Luxembourg and the U.K., in addition to six other branch and field offices within Europe and Asia.

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

ITEM 3. LEGAL PROCEEDINGS

See Note 23 to the Consolidated Financial Statements under "—Litigation and Regulatory Matters" for a description of certain pending litigation and regulatory matters affecting us, and certain risks to our businesses presented by such matters.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

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

General

Prudential Financial's Common Stock trades on the New York Stock Exchange under the symbol "PRU." The following table presents the high and low closing prices for the Common Stock on the New York Stock Exchange during the periods indicated and the dividends declared per share during such periods:

	High	Low	Dividends
2017:			
Fourth Quarter	$117.15	$107.28	$ 0.75
Third Quarter	$115.23	$98.65	$ 0.75

Second Quarter	$109.13	$102.92	$ 0.75
First Quarter	$113.82	$103.92	$ 0.75
2016:			
Fourth Quarter	$107.10	$81.43	$ 0.70
Third Quarter	$81.65	$68.74	$ 0.70
Second Quarter	$79.71	$66.93	$ 0.70
First Quarter	$79.84	$58.00	$ 0.70

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On January 31, 2018, there were 1,295,412 registered holders of record for the Common Stock and 422 million shares outstanding.

Holders of Common Stock will be entitled to dividends if and when declared by Prudential Financial's Board of Directors out of funds legally available to pay those dividends. Prudential Financial's Board of Directors currently intends to continue to declare and pay dividends on the Common Stock. Future dividend decisions will be based on, and affected by, a number of factors including the financial performance of our businesses, our overall financial condition, results of operations, cash requirements and future prospects; regulatory restrictions including on the payment of dividends by Prudential Financial's subsidiaries and capital and liquidity requirements under Dodd-Frank; and such other factors as the Board of Directors may deem relevant. Dividends payable by Prudential Financial are limited to the amount that would be legally available for payment under New Jersey corporate law. For additional information on dividends and related regulatory restrictions, see Note 15 to the Consolidated Financial Statements. For information about our exchangeable surplus notes, see Note 14 to the Consolidated Financial Statements.

Issuer Purchases of Equity Securities

The following table provides information about purchases by the Company during the three months ended December 31, 2017, of its Common Stock.

Period	Total Number of Shares Purchased(1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program(2)	Approximate Dollar Value of Shares that May Yet Be Purchased under the Program(2)
October 1, 2017 through October 31, 2017	950,996	$ 109.90	947,795	
November 1, 2017 through November 30, 2017	939,124	$ 111.56	933,657	
December 1, 2017 through December 31, 2017	897,509	$ 116.25	896,018	
Total	2,787,629	$ 112.50	2,777,470	$ 0

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

(2) In December 2016, Prudential Financial's Board of Directors authorized the Company to repurchase at management's discretion up to $1.25 billion of its outstanding Common Stock during the period from January 1, 2017 through December 31, 2017.

In December 2017, Prudential Financial's Board of Directors authorized the Company to repurchase, at management's discretion, up to $1.5 billion of its outstanding Common Stock during the period from January 1, 2018 through December 31, 2018.

ITEM 6. SELECTED FINANCIAL DATA

We derived the selected consolidated income statement data for the years ended December 31, 2017, 2016 and 2015 and the selected consolidated balance sheet data as of December 31, 2017 and 2016, from our Consolidated Financial

Statements included elsewhere herein. We derived the selected consolidated income statement data for the years ended December 31, 2014 and 2013, and the selected consolidated balance sheet data as of December 31, 2015, 2014 and 2013, from consolidated financial statements not included herein.

See Note 3 to the Consolidated Financial Statements for a discussion of acquisitions during 2017, 2016 and 2015.

The Company's Gibraltar Life consolidated operations use a November 30 fiscal year end for purposes of inclusion in the Company's Consolidated Financial Statements. The Company's consolidated balance sheet data as of December 31, 2017, 2016, 2015, 2014 and 2013, include the assets and liabilities of Gibraltar Life as of November 30 for each respective year. The Company's consolidated income statement data for the years ended December 31, 2017, 2016, 2015, 2014 and 2013 include Gibraltar Life's results of operations for the twelve months ended November 30 for each respective year. Beginning in 2018, the Company intends to eliminate this one-month reporting lag, which is not expected to have a material impact on the Company's Consolidated Financial Statements.

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

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	Year Ended December 31,				
	2017	2016	2015	2014	2013
	(in millions, except per share and ratio information)				
Income Statement Data:					
Revenues:					
Premiums	$32,091	$30,964	$28,521	$29,293	$26,237
Policy charges and fee income	5,303	5,906	5,972	6,179	5,415
Net investment income	16,435	15,520	14,829	15,256	14,729
Asset management and service fees	4,127	3,752	3,772	3,719	3,485
Other income (loss)	1,301	443	0	(1,978)	(3,199)
Realized investment gains (losses), net	432	2,194	4,025	1,636	(5,206)
Total revenues	59,689	58,779	57,119	54,105	41,461
Benefits and expenses:					
Policyholders' benefits	33,794	33,632	30,627	31,587	26,733
Interest credited to policyholders' account balances	3,822	3,761	3,479	4,263	3,111
Dividends to policyholders	2,091	2,025	2,212	2,716	2,050
Amortization of deferred policy acquisition costs	1,580	1,877	2,120	1,973	240
General and administrative expenses	11,915	11,779	10,912	11,807	11,011
Total benefits and expenses	53,202	53,074	49,350	52,346	43,145
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures	6,487	5,705	7,769	1,759	(1,684)
Total income tax expense (benefit)	(1,438)	1,335	2,072	349	(1,058)
Income (loss) from continuing operations before equity in earnings of operating joint ventures	7,925	4,370	5,697	1,410	(626)
Equity in earnings of operating joint ventures, net of taxes	49	49	15	16	59
Income (loss) from continuing operations	7,974	4,419	5,712	1,426	(567)
Income (loss) from discontinued operations, net of taxes	0	0	0	12	7
Net income (loss)	7,974	4,419	5,712	1,438	(560)
Less: Income (loss) attributable to noncontrolling interests	111	51	70	57	107
Net income (loss) attributable to Prudential Financial, Inc.	$7,863	$4,368	$5,642	$1,381	$(667)
EARNINGS PER SHARE(1)					
Basic earnings per share—Common Stock:					
Income (loss) from continuing operations attributable to Prudential Financial, Inc.	$18.19	$9.85	$12.37	$3.23	$(1.57)
Income (loss) from discontinued operations, net of taxes	0.00	0.00	0.00	0.02	0.02
Net income (loss) attributable to Prudential Financial, Inc.	$18.19	$9.85	$12.37	$3.25	$(1.55)
Diluted earnings per share—Common Stock:					
Income (loss) from continuing operations attributable to Prudential Financial, Inc.	$17.86	$9.71	$12.17	$3.20	$(1.57)
Income (loss) from discontinued operations, net of taxes	0.00	0.00	0.00	0.03	0.02
Net income (loss) attributable to Prudential Financial, Inc.	$17.86	$9.71	$12.17	$3.23	$(1.55)
Dividends declared per share—Common Stock	$3.00	$2.80	$2.44	$2.17	$1.73
Ratio of earnings to fixed charges(2)	2.18	2.10	2.64	1.25	0.00

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	As of December 31,				
	2017	2016	2015	2014	2013
	(in millions)				
Balance Sheet Data:					
Total investments excluding policy loans	$457,980	$432,485	$405,535	$408,274	$386,407
Separate account assets	306,617	287,636	285,570	296,435	285,060
Total assets	831,921	783,962	757,255	766,526	731,638
Future policy benefits and policyholders' account balances	405,506	386,113	361,168	353,916	343,516
Separate account liabilities	306,617	287,636	285,570	296,435	285,060
Short-term debt	1,380	1,133	1,216	3,839	2,668
Long-term debt	17,172	18,041	19,594	19,702	23,411
Total liabilities	777,577	737,874	715,332	724,177	695,757
Prudential Financial, Inc. equity	54,069	45,863	41,890	41,770	35,278
Noncontrolling interests	275	225	33	579	603
Total equity	$54,344	$46,088	$41,923	$42,349	$35,881

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(1) For 2017, 2016 and 2015, represents consolidated earnings per share of Common Stock. For 2014 and 2013, represents earnings of the Company's former Financial Services Businesses per share of Common Stock.

(2) For purposes of this computation, earnings are defined as income from continuing operations before income taxes excluding undistributed income (loss) from equity method investments, fixed charges and interest capitalized. Also excludes earnings attributable to noncontrolling interests. Fixed charges are the sum of gross interest expense, interest credited to policyholders' account balances and an estimated interest component of rent expense. Due to the Company's loss for the year ended December 31, 2013, the ratio coverage was less than 1:1 and is therefore not presented. Additional earnings of $1,935 million would have been required for the year ended December 31, 2013 to achieve a ratio of 1:1.

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

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

Overview

During the fourth quarter of 2017, we introduced a new organizational structure for our U.S. businesses that reflects our focus on leveraging our mix of businesses and our digital and customer engagement capabilities to expand our value proposition for the benefit of customers and stakeholders. This new organizational structure retains our existing segments but realigns them under new divisions. Under the new structure, our principal operations are comprised of five divisions, which together encompass seven segments, and our Corporate and Other operations. The U.S. Individual Solutions division consists of our Individual Annuities and Individual Life segments. The U.S. Workplace Solutions division consists of our Retirement and Group Insurance segments. The Investment Management division is comprised of our Investment Management segment (formerly named the Asset Management segment). The International Insurance division continues to consist of our International Insurance segment, and the Closed Block division continues to consist of our Closed Block segment. Our Corporate and Other operations continue to include corporate items and initiatives that are not allocated to business segments and businesses that have been or will be divested. There are no changes to our reporting segments nor to our measure of segment profitability as a result of the new organizational structure.

Revenues and Expenses

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

Profitability

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

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

Executive Summary

Industry Trends

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

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U.S. Businesses

Financial and Economic Environment. As discussed further under “Impact of a Low Interest Rate Environment” below, interest rates in the U.S. remain lower than historical levels, which continue to negatively impact our portfolio income yields and our net investment spread results.

Regulatory Environment. See “Business—Regulation” for a discussion of regulatory developments that may impact the Company and associated risks, including changes in U.S. tax legislation, the Dodd-Frank Wall Street Reform and Consumer Protection Act, the U.S. Department of Labor’s fiduciary rules and fiduciary rules being developed by other regulators.

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

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

International Businesses

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

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

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

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

Impact of a Low Interest Rate Environment

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

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

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

U.S. Operations excluding the Closed Block Division

Interest rates in the U.S. continue to remain lower than historical levels, despite the Federal Reserve Board's actions throughout 2017 to raise short-term interest rates by a total of 75 basis points ("bps"). Market conditions and events make uncertain the timing, amount and impact of any further monetary policy decisions by the Federal Reserve. Given this continued low rate environment, our current reinvestment yields remain lower than the overall portfolio yield, primarily for our investments in fixed maturity securities and commercial mortgage loans and, as a result, our overall portfolio yields are expected to continue to decline.

For the general account supporting our U.S. Individual Solutions division, U.S. Workplace Solutions division, Investment Management division and our Corporate and Other operations, we expect annual scheduled payments and prepayments to be approximately 6.8% of the fixed maturity security and commercial mortgage loan portfolios through 2019. The general account for these operations has approximately $195 billion of such assets (based on net carrying value) as of December 31, 2017. As these assets mature, the average portfolio yield for fixed maturities and commercial mortgage loans of approximately 4.2%, as of December 31, 2017, is expected to decline due to reinvesting in a lower interest rate environment.

Included in the $195 billion of fixed maturity securities and commercial mortgage loans are approximately $108 billion that are subject to call or redemption features at the issuer's option and have a weighted average interest rate of approximately 4%. Of this $108 billion, approximately 65% contain provisions for prepayment premiums. The reinvestment of scheduled payments or prepayments (not subject to a prepayment fee) at rates below the current portfolio yield, including in some cases at rates below those guaranteed under our insurance contracts, will impact future operating results to the extent we do not, or are unable to, reduce crediting rates on in force blocks of business, or effectively utilize other asset/liability management strategies described below, in order to maintain current net interest margins.

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

	As of December 31, 2017 ($ in billions)
Long-duration insurance products with fixed and guaranteed terms	$ 115
Contracts with adjustable crediting rates subject to guaranteed minimums	56
Participating contracts where investment income risk ultimately accrues to contractholders	15
Total	$ 186

The $115 billion above relates to long-duration products such as group annuities, structured settlements and other insurance products that have fixed and guaranteed terms, for which underlying assets may have to be reinvested at interest rates that are lower than portfolio rates. We seek to mitigate the impact of a prolonged low interest rate environment on these contracts through asset/liability management, as discussed further below.

The $56 billion above relates to contracts with crediting rates that may be adjusted over the life of the contract, subject to guaranteed minimums. Although we may have the ability to lower crediting rates for those contracts above guaranteed minimums, our willingness to do so may be limited by competitive pressures. The following table sets forth the related account values by range of guaranteed minimum crediting rates and the related range of the difference, in bps, between rates being credited to contractholders as of December 31, 2017, and the respective guaranteed minimums.

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	Account Values with Adjustable Crediting Rates Subject to Guaranteed Minimums:					
	At guaranteed minimum	1-49 bps above guaranteed minimum	50-99 bps above guaranteed minimum	100-150 bps above guaranteed minimum	Greater than 150 bps above guaranteed minimum	Total
	($ in billions)					
Range of Guaranteed Minimum Crediting Rates:						
Less than 1.00%	$0.4	$ 1.1	$ 0.4	$ 0.1	$ 0.0	$2.0
1.00% - 1.99%	1.0	9.6	6.4	1.5	0.3	18.8
2.00% - 2.99%	0.9	0.6	0.4	2.5	0.4	4.8
3.00% - 4.00%	26.5	2.7	0.2	0.1	0.0	29.5
Greater than 4.00%	1.0	0.0	0.0	0.0	0.0	1.0
Total(1)	$29.8	$ 14.0	$ 7.4	$ 4.2	$ 0.7	$56.1
Percentage of total	54 %	25 %	13 %	7 %	1 %	100 %

(1) Includes approximately $0.9 billion related to contracts that impose a market value adjustment if the invested amount is not held to maturity.

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

Assuming a hypothetical scenario where the average 10-year U.S. Treasury rate is 2.70% for the period from January 1, 2018 through December 31, 2019, and credit spreads remain unchanged from levels as of December 31, 2017, we estimate that the unfavorable impact to pre-tax adjusted operating income of reinvesting in such an environment, compared to reinvesting at current average portfolio yields, would be approximately $14 million in 2018 and $43 million in 2019. This impact is most significant in the Retirement and Individual Annuities segments. This hypothetical scenario only reflects the impact related to the approximately $56 billion of contracts shown in the table above, and does not reflect: any benefit from potential changes to the crediting rates on the corresponding contractholder liabilities where the Company has the contractual ability to do so, or other potential mitigants such as changes in investment mix that we may implement as funds are reinvested; any impact related to assets that do not directly support our liabilities; any impact from other factors, including but not limited to, new business, contractholder behavior, product modifications, changes in product offerings, changes in competitive conditions or changes in capital markets; or any impact from other factors described below. See "—Segment Measures" for a discussion of adjusted operating income and its use as a measure of segment operating performance.

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

Closed Block Division

Substantially all of the $61 billion of general account assets in the Closed Block division support obligations and liabilities relating to the Closed Block policies only. See Note 12 to the Consolidated Financial Statements for further information on the Closed Block.

International Insurance Operations

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

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

	As of December 31, 2017 ($ in billions)
Long-duration insurance products with fixed and guaranteed terms	$ 125
Contracts with a market value adjustment if invested amount is not held to maturity	24
Contracts with adjustable crediting rates subject to guaranteed minimums	10
Total	$ 159

The $125 billion above is predominantly comprised of long-duration insurance products that have fixed and guaranteed terms, for which underlying assets may have to be reinvested at interest rates that are lower than current portfolio yields. The remaining insurance liabilities and policyholder account balances include $24 billion related to contracts that impose a market value adjustment if the invested amount is not held to maturity and $10 billion related to contracts with crediting rates that may be adjusted over the life of the contract, subject to guaranteed minimums. Most of the current crediting rates on these contracts, however, are at or near contractual minimums. Although we have the ability in some cases to lower crediting rates for those contracts that are above guaranteed minimum crediting rates, the majority of this business has interest crediting rates that are determined by formula.

Assuming a hypothetical scenario within our Japanese and Korean operations where 2018 new money yields would be 25 basis points lower than projected, and applying these lower new money yields to annualized investment of renewal premiums, proceeds from investment disposition and reinvestment of investment income, we estimate that the unfavorable impact would reduce adjusted operating income in 2018 by approximately $10 to $15 million. This hypothetical scenario excludes first-year premium, single pay premium, multi-currency fixed annuity cash flows, any potential benefit from repricing products, and any impact from other factors, including but not limited to new business, contractholder behavior, changes in competitive conditions, changes in capital markets, and the effect of derivative instruments.

Outlook

Management expects that results in 2018 will continue to benefit from our complementary mix of high-quality protection, retirement and investment management businesses. This business mix provides a diversity in earnings sources, which helps offset variability in business results or fluctuations in market conditions, while offering growth opportunities. While challenges exist in the form of a low interest rate environment (see “Impact of a Low Interest Rate Environment”), fee compression in certain of our businesses and an evolving regulatory environment (see “Business—Regulation”), we expect that our choice of businesses coupled with strong execution will produce attractive returns. Outlook considerations for each of our divisions include the following:

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- U.S. Individual Solutions. Our Individual Annuities business remains focused on helping its customers meet their investment and retirement needs. We expect continued strong results with near-term returns on assets above our long-term target. In addition, we expect our free cash flow to be high given the stability in our block and the challenged industry-wide sales environment. We have been enhancing our risk management strategy to optimize the mix of derivatives and cash instruments which will cause some downward pressure on returns over time, but is expected to produce less volatile net income and cash flows, particularly in adverse scenarios. In addition, we expect a natural fee rate reduction due to the maturation of the existing block and due to sales of newer products which generally have lower rate structures. Furthermore, we expect our recent favorable hedging outcomes to normalize. We expect the combination of these factors to cause our returns on assets to migrate to the long-term target over time. We continue to execute on our product diversification strategy and remain focused on a broad range of outcome-oriented solutions for customers. Over the near-term, we expect the challenged industry sales environment to persist, and given a more muted equity growth assumption than in prior years, we expect a slight decline in account values. Our Individual Life business is continuing to execute on its product diversification strategy in order to maintain a diversified product mix and an attractive risk profile. We continue to deepen relationships with distribution partners while developing a more customer-oriented experience. Product actions over the last several months could result in a slightly higher portion of sales in term and variable life over the next several quarters, but we remain committed to achieving a diversified product offering.

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

- Investment Management. PGIM, our investment management business, is making targeted investments to further diversify its product offerings, continue to build a broader international presence, deepen its solutions capability, and further strengthen external recognition as a leading global asset manager. These capabilities will enable PGIM to continue to meet our clients’ evolving needs and, in turn, to generate flows across multiple asset classes, client segments and geographies. Underpinning our growth strategy is our ability to continue to deliver robust investment performance, and to attract and retain high-caliber investment talent. While we are experiencing fee pressure in line with the industry, our average fee yield has remained relatively flat due to new flows coming into higher fee yielding strategies within fixed income, equities and real estate, and because of our diverse business profile.

- International Markets. We continue to concentrate on deepening our presence in Japan and other markets in which we currently operate and expanding our distribution capabilities in emerging markets. The returns on our death protection products are largely driven by mortality margins which helps mitigate the exposure of results to interest rates. We have seen a shift in sales mix with a greater emphasis on U.S. dollar-denominated products in Japan. We expect this trend to continue. We are also focused on achieving scale in select growth markets outsides of Japan. With regard to distribution, we are seeking modest growth in our Life Planner count in Japan but we do expect a decline in Gibraltar Life Consultants as we continue to focus on increasing quality and productivity standards.

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

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

Results of Operations

Consolidated Results of Operations

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

	Year ended December 31,		
	2017	2016	2015
	(in millions)		
Revenues	$59,689	$58,779	$57,119
Benefits and expenses	53,202	53,074	49,350
Income (loss) before income taxes and equity in earnings of operating joint ventures	6,487	5,705	7,769
Income tax expense (benefit)	(1,438)	1,335	2,072
Income (loss) before equity in earnings of operating joint ventures	7,925	4,370	5,697
Equity in earnings of operating joint ventures, net of taxes	49	49	15
Net income (loss)	7,974	4,419	5,712
Less: Income attributable to noncontrolling interests	111	51	70
Net income (loss) attributable to Prudential Financial, Inc.	$7,863	$4,368	$5,642

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

- $2,773 million favorable impact reflecting a tax benefit in the current year compared to a tax expense in the prior year primarily as a result of tax reform (see “—Income Taxes”);

- $1,927 million net favorable variance, on a pre-tax basis, primarily from higher operating results from our business segments and income in the current period from our Divested Businesses compared to a loss in the prior year;

- $1,500 million favorable variance, on a pre-tax basis, reflecting changes to the way we manage interest rate risks for certain products. This variance is primarily attributed to changes in our Individual Annuities risk management strategy implemented in 2016, whereby we terminated the existing intercompany derivative transactions between our Corporate and Other operations and Individual Annuities related to managing interest rate risk and we now manage this risk within the Individual Annuities business segment (see “—Results of Operations by Segment—Corporate and Other—Capital Protection Framework” for additional information); and

- $478 million favorable variance, on a pre-tax basis, from adjustments to DAC and other costs as well as reserves, reflecting updates to the estimated profitability of our businesses, including the impact of our annual reviews and update of assumptions and other refinements. This excludes the impact associated with the variable annuity hedging program discussed below (see “—Results of Operations by Segment—U.S. Individual Solutions Division—Individual Annuities” for additional information).

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

- $2,373 million unfavorable variance, on a pre-tax basis, reflecting the net impact from changes in the value of our embedded derivatives and related hedge positions associated with certain variable annuities (see "—Results of Operations by Segment—U.S. Individual Solutions Division—Individual Annuities—Variable Annuity Risks and Risk Mitigants" for additional information); and

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- $810 million lower net pre-tax realized gains for PFI excluding the Closed Block division, and excluding the impact of the hedging program associated with certain variable annuities discussed above (see "—Realized Investment Gains and Losses" for additional information).

2016 to 2015 Annual Comparison. The $1,274 million decrease in "Net income (loss) attributable to Prudential Financial, Inc." reflected the following notable items:

- $980 million unfavorable variance, on a pre-tax basis, from adjustments to DAC and other costs as well as reserves, reflecting updates to the estimated profitability of our businesses, including the impact of our annual reviews and update of assumptions and other refinements. This excludes the impact associated with the variable annuity hedging program discussed below (see "—Results of Operations by Segment—U.S. Individual Solutions Division—Individual Annuities" for additional information);

- $972 million unfavorable variance, on a pre-tax basis, reflecting our decision to manage a portion of our interest rate risk through our Capital Protection Framework (see "—Results of Operations by Segment—Corporate and Other—Capital Protection Framework" for additional information); and

- $479 million lower net pre-tax realized gains for PFI excluding the Closed Block division, and excluding the impact of the hedging program associated with certain variable annuities, which is discussed below (see "—Realized Investment Gains and Losses" for additional information).

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

- $737 million favorable impact of lower tax expense reflecting lower pre-tax income in 2016 compared to 2015; and

- $660 million favorable variance, on a pre-tax basis, reflecting the net impact from changes in the value of our embedded derivatives and related hedge positions associated with certain variable annuities and other products (see "—Results of Operations by Segment—U.S. Individual Solutions Division—Individual Annuities—Variable Annuity Risks an Risk Mitigants" for additional information).

Segment Results of Operations

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

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

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	Year ended December 31,		
	2017	2016	2015
	(in millions)		
Adjusted operating income before income taxes by segment:			
Individual Annuities	$2,198	$1,765	$1,797
Individual Life	(191)	79	635
Total U.S. Individual Solutions division(1)	2,007	1,844	2,432
Retirement	1,244	1,012	931
Group Insurance	253	220	176
Total U.S. Workplace Solutions division(1)	1,497	1,232	1,107
Investment Management	979	787	779
Total Investment Management division(1)	979	787	779
International Insurance	3,198	3,117	3,226
Total International Insurance division	3,198	3,117	3,226
Corporate and Other operations	(1,437)	(1,581)	(1,313)
Total Corporate and Other	(1,437)	(1,581)	(1,313)
Total segment adjusted operating income before income taxes	6,244	5,399	6,231
Reconciling items:			
Realized investment gains (losses), net, and related adjustments(2)	(602)	989	2,258
Charges related to realized investment gains (losses), net(3)	544	(466)	(679)
Investment gains (losses) on trading account assets supporting insurance liabilities, net(4)	336	(17)	(524)
Change in experience-rated contractholder liabilities due to asset value changes(5)	(151)	21	433
Divested businesses(6):			
Closed Block division	45	(132)	58
Other divested businesses	38	(84)	(66)
Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests(7)	33	(5)	58
Consolidated income (loss) before income taxes and equity in earnings of operating joint ventures	$6,487	$5,705	$7,769

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(1) Prior period divisional subtotals are presented on a basis consistent with the Company’s new organizational structure. Individual segment results and consolidated totals remain unchanged. See “—Overview” for additional information.

(2) Represents “Realized investment gains (losses), net,” and related adjustments. See “—Realized Investment Gains and Losses” and Note 22 to our Consolidated Financial Statements for additional information.

(3) Includes charges that represent the impact of realized investment gains (losses), net, on the amortization of DAC and other costs, and on changes in reserves. Also includes charges resulting from payments related to market value adjustment features of certain of our annuity products and the impact of realized investment gains (losses), net, on the amortization of unearned revenue reserves.

(4) Represents net investment gains (losses) on trading account assets supporting insurance liabilities. See “—Experience-Rated Contractholder Liabilities, Trading Account Assets Supporting Insurance Liabilities and Other Related Investments.”

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

(6) Represents the contribution to income (loss) of divested businesses that have been or will be sold or exited, including businesses that have been placed in wind down, but that did not qualify for “discontinued operations” accounting treatment under U.S. GAAP. See “—Divested Businesses.”

(7) Equity in earnings of operating joint ventures are included in adjusted operating income but excluded from income before income taxes and equity in earnings of operating joint ventures as they are reflected on an after-tax U.S. GAAP basis as a separate line in our Consolidated Statements of Operations. Earnings attributable to noncontrolling interests are excluded from adjusted operating income but included in income before taxes and equity earnings of operating joint ventures as they are reflected on a U.S. GAAP basis as a separate line in our Consolidated Statements of Operations. Earnings attributable to noncontrolling interests represent the portion of earnings from consolidated entities that relates to the equity interests of minority investors.

Segment results for 2017 presented above reflect the following:

Individual Annuities. Segment results for 2017 increased in comparison to 2016, primarily reflecting higher asset-based fee income, lower amortization costs and higher net investment spread results. Both periods also experienced favorable comparative net impacts from changes in the estimated profitability of the business, including those resulting from our annual reviews and update of assumptions and other refinements.

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Individual Life. Segment results for 2017 decreased in comparison to 2016, primarily reflecting unfavorable comparative net impacts from our annual reviews and update of assumptions and other refinements, higher general and administrative expenses and an unfavorable impact from mortality experience, net of reinsurance, partially offset by a higher contribution from net investment spread results.

Retirement. Segment results for 2017 increased in comparison to 2016, reflecting higher net investment spread results and a higher contribution from reserve experience.

Group Insurance. Segment results for 2017 increased in comparison to 2016, reflecting favorable comparative net impacts from our annual reviews and update of assumptions and other refinements, net favorable underwriting results and higher net investment spread results, partially offset by higher expenses.

Investment Management. Segment results for 2017 increased in comparison to 2016, primarily reflecting higher asset management fees, net of related expenses, and higher other related revenues, net of associated expenses, partially offset by higher expenses.

International Insurance. Segment results for 2017 increased in comparison to 2016, inclusive of unfavorable net impacts from foreign currency exchange rates and comparatively favorable net impacts from our annual reviews and update of assumptions and other refinements. Excluding these items, segment results increased from the prior year, primarily reflecting the growth of business in force and improved policyholder experience, partially offset by higher expenses, including legal costs and expenses supporting business growth.

Corporate and Other operations. The results for 2017 reflected a decreased loss in comparison to 2016, driven by higher investment income, net of interest expense, higher income from our qualified pension plan, and lower levels of other corporate expenses.

Closed Block Division. Results for 2017 increased in comparison to 2016, primarily driven by an increase in net realized investment gains and related activity, net insurance activity and higher net investment income, partially offset by an increase in the policyholder dividend obligation.

Segment Measures

Adjusted Operating Income. In managing our business, we analyze our segments' operating performance using "adjusted operating income." Adjusted operating income does not equate to "Income (loss) before income taxes and equity in earnings of operating joint ventures" or "Net income (loss)" as determined in accordance with U.S. GAAP, but is the measure of segment profit or loss we use to evaluate segment performance and allocate resources, and consistent with authoritative guidance, is our measure of segment performance. The adjustments to derive adjusted operating income are important to an understanding of our overall results of operations. Adjusted operating income is not a substitute for income determined in accordance with U.S. GAAP, and our definition of adjusted operating income may differ from that used by other companies. However, we believe that the presentation of adjusted operating income as we measure it for management purposes enhances the understanding of our results of operations by highlighting the results from ongoing operations and the underlying profitability of our businesses. See Note 22 to the Consolidated Financial Statements for further information on the presentation of segment results and our definition of adjusted operating income.

Annualized New Business Premiums. In managing our Individual Life, Group Insurance and International Insurance businesses, we analyze annualized new business premiums, which do not correspond to revenues under U.S. GAAP. Annualized new business premiums measure the current sales performance of the business, while revenues primarily reflect the renewal persistency of policies written in prior years and net investment income, in addition to current sales. Annualized new business premiums include 10% of first year premiums or deposits from single pay products. No other adjustments are made for limited pay contracts.

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

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Assets Under Management. In managing our Investment Management business, we analyze assets under management (which do not correspond directly to U.S. GAAP assets) because the principal source of revenues is fees based on assets under management. Assets under management represents the fair market value or account value of assets which we manage directly for institutional clients, retail clients, and for our general account, as well as assets invested in our products that are managed by third-party managers.
Account Values. In managing our Individual Annuities and Retirement businesses, we analyze account values, which do not correspond to U.S. GAAP assets. Net sales (redemptions) in our Individual Annuities business and net additions (withdrawals) in our Retirement business do not correspond to revenues under U.S. GAAP, but are used as a relevant measure of business activity.

Impact of Foreign Currency Exchange Rates

Foreign currency exchange rate movements and related hedging strategies

As a U.S.-based company with significant business operations outside the U.S., particularly in Japan, we are subject to foreign currency exchange rate movements that could impact our U.S. dollar-equivalent earnings and shareholder return on equity. We seek to mitigate this impact through various hedging strategies, including the use of derivative contracts and by holding U.S. dollar-denominated assets in certain of our foreign subsidiaries.

The operations of certain of our businesses are subject to currency fluctuations that could materially affect our U.S. dollar-equivalent earnings from period to period, even if earnings on a local currency basis are relatively constant. We enter into forward currency derivative contracts as part of our strategy to effectively fix the currency exchange rates for a portion of our prospective non-U.S. dollar-denominated earnings streams, thereby reducing earnings volatility from foreign currency exchange rate movements. The forward currency hedging program is primarily associated with our insurance operations in Japan and Korea.

For further information on the hedging strategies used to mitigate the risks of foreign currency exchange rate movements on earnings as well as the U.S. GAAP earnings impact from products denominated in non-local currencies, see "—Impact of foreign currency exchange rate movements on earnings," below.

We utilize a yen hedging strategy that calibrates the hedge level to preserve the relative contribution of our yen-based business to the Company's overall return on equity on a leverage neutral basis. We implement this hedging strategy utilizing a variety of instruments, including foreign currency derivative contracts, as discussed above, as well as U.S. dollar-denominated assets and, to a lesser extent, "dual currency" and "synthetic dual currency" assets held locally in our Japanese insurance subsidiaries. We may also hedge using instruments held in our U.S. domiciled entities, such as U.S. dollar-denominated debt that has been swapped to yen. The total hedge level may vary based on our periodic assessment of the relative contribution of our yen-based business to the Company's overall return on equity.

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

	December 31, 2017	2016
	(in billions)	
Instruments hedging foreign currency exchange rate exposure on U.S. dollar-equivalent earnings:		
Forward currency hedging program(1)	$ 1.6	$ 1.6
Instruments hedging foreign currency exchange rate exposure on U.S. dollar-equivalent equity:		

U.S. dollar-denominated assets held in yen-based entities(2):		
U.S. dollar-denominated investments, at amortized cost	13.7	12.6
Other	0.1	0.1
Subtotal	13.8	12.7
Dual currency and synthetic dual currency investments(3)	0.6	0.7
Total instruments hedging foreign currency exchange rate exposure on U.S. dollar-equivalent equity	14.4	13.4
Total hedges	$ 16.0	$ 15.0

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(1) Represents the notional amount of forward currency contracts outstanding.

(2) Excludes $41.2 billion and $36.2 billion as of December 31, 2017 and 2016, respectively, of U.S. dollar-denominated assets supporting U.S. dollar-denominated liabilities related to U.S. dollar-denominated products issued by our Japanese insurance operations.

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(3) Dual currency and synthetic dual currency investments are held by our yen-based entities in the form of fixed maturities and loans with a yen-denominated principal component and U.S. dollar-denominated interest income. The amounts shown represent the present value of future U.S. dollar-denominated cash flows.

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

These U.S. dollar-denominated investments also pay a coupon which is generally higher than what a similar yen-denominated investment would pay. The incremental impact of this higher yield on our U.S. dollar-denominated investments, as well as our dual currency and synthetic dual currency investments, will vary over time, and is dependent on the duration of the underlying investments as well as interest rate environments in both the U.S. and Japan at the time of the investments. See "—General Account Investments—Investment Results" for a discussion of the investment yields generated by our Japanese insurance operations.

Impact of foreign currency exchange rate movements on earnings

The financial results of our International Insurance, Retirement and Investment Management segments reflect the impact of intercompany arrangements with our Corporate and Other operations pursuant to which certain of these segments' non-U.S. dollar-denominated earnings are translated at fixed currency exchange rates. Results of our Corporate and Other operations include any differences between the translation adjustments recorded by the segments at the fixed currency exchange rate versus the actual average rate during the period. In addition, specific to our International Insurance segment where we hedge certain currencies, as further discussed below, the results of our Corporate and Other operations also include the impact of any gains or losses recorded from the forward currency contracts that settled during the period, which include the impact of any over or under hedging of actual earnings that differ from projected earnings.

For International Insurance, the fixed currency exchange rates are generally determined in connection with a foreign currency income hedging program designed to mitigate the impact of exchange rate changes on the segment's U.S. dollar-equivalent earnings. Pursuant to this program, our Corporate and Other operations execute forward currency contracts with third parties to sell the net exposure of projected earnings for certain currencies in exchange for U.S. dollars at specified exchange rates. The maturities of these contracts correspond with the future periods (typically on a three-year rolling basis) in which the identified non-U.S. dollar-denominated earnings are expected to be generated. In establishing the level of non-U.S. dollar-denominated earnings that will be hedged through this program, we exclude the anticipated level of U.S. dollar-denominated earnings that will be generated by U.S. dollar-denominated products and investments. For the twelve months ended December 31, 2017, approximately 24% of the segment's earnings were yen-based and, as of December 31, 2017, we have hedged 100%, 73% and 28% of expected yen-based earnings for 2018, 2019 and 2020, respectively. To the extent currently unhedged, our International Insurance segment's future expected U.S. dollar-equivalent of yen-based earnings will be impacted by yen exchange rate movements.

As a result of these arrangements, our International Insurance segment's results for 2017, 2016 and 2015 reflect the impact of translating yen-denominated earnings at fixed currency exchange rates of 112, 106 and 91 yen per U.S.

dollar, respectively, and Korean won-denominated earnings at fixed currency exchange rates of 1130, 1100 and 1120 Korean won per U.S. dollar, respectively. We expect our 2018 results to reflect the impact of translating yen-denominated earnings at a fixed currency exchange rate of 111 yen per U.S. dollar and Korean won-denominated earnings at a fixed currency exchange rate of 1150 won per U.S. dollar. Since determination of the fixed currency exchange rates for a given year is impacted by changes in foreign currency exchange rates over time, the segment's future earnings will ultimately be impacted by these changes in exchange rates.

For Retirement, Investment Management and certain currencies within International Insurance, the fixed currency exchange rates for the current year are predetermined during the third quarter of the prior year using forward currency exchange rates.

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

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	Year ended December 31,		
	2017	2016	2015
	(in millions)		
Segment impacts of intercompany arrangements:			
International Insurance	$3	$23	$331
Retirement	2	9	0
Investment Management	0	6	0
Impact of intercompany arrangements(1)	5	38	331
Corporate and Other operations:			
Impact of intercompany arrangements(1)	(5)	(38)	(331)
Settlement gains (losses) on forward currency contracts(2)	(16)	38	286
Net benefit (detriment) to Corporate and Other operations	(21)	0	(45)
Net impact on consolidated revenues and adjusted operating income	$(16)	$38	$286

(1) Represents the difference between non-U.S. dollar-denominated earnings translated on the basis of weighted average monthly currency exchange rates versus fixed currency exchange rates determined in connection with the foreign currency income hedging program.

(2) As of December 31, 2017, 2016 and 2015, the notional amounts of these forward currency contracts within our Corporate and Other operations were $2.8 billion, $2.7 billion and $2.4 billion, respectively, of which $1.5 billion, $1.6 billion and $1.9 billion, respectively, were related to our Japanese insurance operations.

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

While our international insurance operations offer products denominated in local currency, several also offer products denominated in non-local currencies, most notably our Japanese operations, which offer U.S. and Australian dollar-denominated products. The non-local currency-denominated insurance liabilities related to these products are supported by investments denominated in corresponding currencies, including a significant portion designated as available-for-sale. While the impact from foreign currency exchange rate movements on these non-local currency-denominated assets and liabilities is economically matched, differences in the accounting for changes in the value of these assets and liabilities due to changes in foreign currency exchange rate movements have historically resulted in volatility in U.S. GAAP earnings.

In the first quarter of 2015 we implemented a structure in Gibraltar Life’s operations that disaggregated the U.S. and Australian dollar-denominated businesses into separate divisions, each with its own functional currency that aligns with the underlying products and investments. The result of this alignment was to reduce differences in the accounting for changes in the value of these assets and liabilities that arise due to changes in foreign currency exchange rate movements. For the U.S. and Australian dollar-denominated assets that were transferred under this structure, the net cumulative unrealized investment gains associated with foreign exchange remeasurement that were recorded in “Accumulated other comprehensive income (loss)” (“AOCI”) totaled $6.0 billion and will be recognized in earnings within “Realized investment gains (losses), net” over time as these assets mature or are sold. As of December 31, 2017, the remaining net cumulative unrealized investment gains balance related to these assets was $3.9 billion. Absent the sale of any of these assets prior to their stated maturity, approximately 8% of the $3.9 billion balance will be recognized in 2018, approximately 9% will be recognized in 2019, and a majority of the remaining balance will be recognized from 2020 through 2024.

Accounting Policies & Pronouncements

Application of Critical Accounting Estimates

The preparation of financial statements in conformity with U.S. GAAP requires the application of accounting policies that often involve a significant degree of judgment. Management, on an ongoing basis, reviews estimates and assumptions used in the preparation of financial statements. If management determines that modifications in assumptions and estimates are appropriate given current facts and circumstances, the Company's results of operations and financial position as reported in the Consolidated Financial Statements could change significantly.

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

Insurance Assets

Deferred Policy Acquisition Costs and Deferred Sales Inducements

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We capitalize costs that are directly related to the acquisition or renewal of insurance and annuity contracts. These costs primarily include commissions, as well as costs of policy issuance and underwriting and certain other expenses that are directly related to successfully negotiated contracts. We have also deferred costs associated with sales inducements related to our variable and fixed annuity contracts primarily within our Individual Annuities segment. Sales inducements are amounts that are credited to the policyholders' account balances mainly as an inducement to purchase the contract. For additional information about sales inducements, see Note 11 to the Consolidated Financial Statements. We generally amortize DAC and deferred sales inducements ("DSI") over the expected lives of the contracts, based on our estimates of the level and timing of gross premiums, gross profits, or gross margins, depending on the type of contract. As described in more detail below, in calculating DAC and DSI amortization, we are required to make assumptions about investment returns, mortality, persistency, and other items that impact our estimates of the level and timing of gross margins, gross profits, or gross premiums. We also periodically evaluate the recoverability of our DAC and DSI. For certain contracts, this evaluation is performed as part of our premium deficiency testing, as discussed further below in "—Insurance Liabilities—Future Policy Benefits." As of December 31, 2017, DAC and DSI for PFI excluding the Closed Block division were $18.7 billion and $1.2 billion, respectively, and DAC in our Closed Block division was $299 million.

Amortization methodologies

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

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

Gross Margins. DAC associated with the traditional participating products of our Closed Block is amortized over the expected lives of those contracts in proportion to estimated gross margins. Gross margins are defined as: i) amounts received from premiums, earned from investment of policyholder balances and other assessments, less ii) benefits claims paid, costs for contract administration, changes in the net level premium reserve for death and endowment benefits, annual policyholder dividends and other credits. We evaluate our estimates of future gross margins and adjust the related DAC balance with a corresponding charge or credit to current period earnings for the effects of actual gross margins and changes in our expected future gross margins. DAC adjustments for these participating products generally have not created significant volatility in our results of operations since many of the factors that affect gross margins are also included in the determination of our dividends to these policyholders and, during most years, the Closed Block has recognized a cumulative policyholder dividend obligation expense in “Policyholders’ dividends,” for the excess of actual cumulative earnings over expected cumulative earnings as determined at the time of demutualization. However, if actual cumulative earnings fall below expected cumulative earnings in future periods, thereby eliminating the cumulative policyholder dividend obligation expense, changes in gross margins and DAC amortization would result in a net impact to the Closed Block results of operations. As of December 31, 2017, the excess of actual cumulative earnings over the expected cumulative earnings was $1,790 million.

The amortization methodologies for products not discussed above primarily relate to less significant DAC and DSI balances associated with products in our Group Insurance and Retirement segments, which comprised approximately 2% of the Company’s total DAC and DSI balances as of December 31, 2017.

Annual assumptions review and quarterly adjustments

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

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

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

The near-term future equity rate of return assumption used in evaluating DAC and other costs for our domestic variable annuity and variable life insurance products is derived using a reversion to the mean approach, a common industry practice. Under this approach, we consider historical equity returns and adjust projected equity returns over an initial future period of five years (the "near-term") so that equity returns converge to the long-term expected rate of return. If the near-term projected future rate of return is greater than our near-term maximum future rate of return of 15%, we use our maximum future rate of return. As of December 31, 2017, our variable annuities and variable life insurance businesses assume an 8.0% long-term equity expected rate of return and a 3.3% near-term mean reversion equity expected rate of return.

The weighted average rate of return assumptions consider many factors specific to each business, including asset durations, asset allocations and other factors. We generally update the near-term equity rates of return and our estimate of total gross profits each quarter to reflect the result of the reversion to the mean approach. We generally update the future interest rates used to project fixed income returns annually and in any quarter when interest rates vary significantly from these assumptions. As a result of our 2017 annual reviews and update of assumptions and other refinements, we reduced our long-term expectation of the 10-year U.S. Treasury rate by 25 basis points and now grade to 3.75% over ten years and we reduced the long-term expected return by 40 basis points on Japanese government bonds and now grade to 1.5% over ten years.

These market performance related adjustments to our estimate of total gross profits result in cumulative adjustments to prior amortization, reflecting the application of the new required rate of amortization to all prior periods' gross profits.

Value of Business Acquired

In addition to DAC and DSI, we also recognize an asset for VOBA. VOBA is an intangible asset which represents an adjustment to the stated value of acquired inforce insurance contract liabilities to present them at fair value, determined as of the acquisition date. VOBA is amortized over the expected life of the acquired contracts using the same methodology and assumptions used to amortize DAC and DSI (see "—Deferred Policy Acquisition Costs and Deferred Sales Inducements" above for additional information). VOBA is also subject to recoverability testing. As of December 31, 2017, VOBA was $1.6 billion, and included $1.2 billion related to the acquisition from American International Group ("AIG") of AIG Star Life Insurance Co., Ltd, AIG Edison Life Insurance Company, AIG Financial Assurance Japan K.K. and AIG Edison Service Co., Ltd. (collectively, the "Star and Edison Businesses") in 2011, and $0.1 billion related to the acquisition of The Hartford Financial Services Group's individual life insurance business ("the Hartford Life Business") in 2013. The remaining $0.3 billion primarily relates to previously-acquired traditional life, deferred annuity, defined contribution and defined benefit businesses. The VOBA associated with the inforce contracts of the Star and Edison Businesses is less sensitive to assumption changes, as the majority is amortized in proportion to gross premiums which are more predictably stable compared to gross profits.

Insurance Liabilities

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Future Policy Benefits

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

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

- For most long-duration contracts, we utilize a net premium valuation methodology in measuring the liability for future policy benefits. Under this methodology, a liability for future policy benefits is accrued when premium revenue is recognized. The liability, which represents the present value of future benefits to be paid to or on behalf of policyholders and related expenses less the present value of future net premiums (portion of the gross premium required to provide for all benefits and expenses), is estimated using methods that include assumptions applicable at the time the insurance contracts are made with provisions for the risk of adverse deviation, as appropriate. Original assumptions continue to be used in subsequent accounting periods to determine changes in the liability for future policy benefits (often referred to as the "lock-in concept") unless a premium deficiency exists. The result of the net premium valuation methodology is that the liability at any point in time represents an accumulation of the portion of premiums received to date expected to be needed to fund future benefits (i.e., net premiums received to date), less any benefits and expenses already paid. The liability does not necessarily reflect the full policyholder obligation the Company expects to pay at the conclusion of the contract since a portion of that obligation would be funded by net premiums received in the future and would be recognized in the liability at that time. We perform premium deficiency tests using best estimate assumptions as of the testing date without provisions for adverse deviation. If the liabilities determined based on these best estimate assumptions are greater than the net reserves (i.e., GAAP reserves net of any DAC, DSI or VOBA asset), the existing net reserves are adjusted by first reducing these assets by the amount of the deficiency or to zero through a charge to current period earnings. If the deficiency is more than these asset balances for insurance contracts, we then increase the net reserves by the excess, again through a charge to current period earnings. If a premium deficiency is recognized, the assumptions as of the premium deficiency test date are locked in and used in subsequent valuations and the net reserves continue to be subject to premium deficiency testing. In addition, for limited-payment contracts, future policy benefit reserves also include a deferred profit liability representing gross premiums received in excess of net premiums. The deferred profits are recognized in revenue in a constant relationship with insurance in force or with the amount of expected future benefit payments.
- For certain contract features, such as those related to guaranteed minimum death benefits ("GMDB"), guaranteed minimum income benefits ("GMIB") and no-lapse guarantees, a liability is established when associated assessments (which include all policy charges including charges for administration, mortality, expense, surrender, and other. regardless of how characterized) are recognized. This liability is established utilizing current best estimate assumptions and is based on the ratio of the present value of total expected excess payments over the life of the contract divided by the present value of total expected assessments (i.e., benefit ratio). The liability equals the current benefit ratio multiplied by cumulative assessments recognized to date, plus interest, less cumulative excess payments to date. Similar to as described above for DAC, the reserves are subject to adjustments based on annual reviews of assumptions and quarterly adjustments for experience, including market performance. These adjustments reflect the impact on the benefit ratio of using actual historical experience from the issuance date to the balance sheet date plus updated estimates of future experience. The updated benefit ratio is then applied to all prior periods' assessments to derive an adjustment to the reserve recognized through a benefit or charge to current period earnings.
- For certain product guarantees, primarily certain optional living benefit features of the variable annuity products in our Individual Annuities segment including guaranteed minimum accumulation benefits ("GMAB"), guaranteed minimum withdrawal benefits ("GMWB") and guaranteed minimum income and withdrawal benefits ("GMIWB"), the benefits are accounted for as embedded derivatives using a fair value accounting framework. The fair value of these contracts is calculated as the present value of expected future benefit payments to contractholders less the present value of assessed rider fees attributable to the embedded derivative feature. Under U.S. GAAP, the fair values of these benefit features are based on assumptions a market participant would use in valuing these embedded derivatives.

Changes in the fair value of the embedded derivatives are recorded quarterly through a benefit or charge to current period earnings.

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

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

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International Insurance. The reserves for future policy benefits of our International Insurance segment, which as of December 31, 2017, represented 45% of our total future policy benefit reserves, primarily relate to non-participating whole life and term life products and endowment contracts, and are generally calculated using the net premium valuation methodology, as described above. The primary assumptions used in determining expected future benefits and expenses include mortality, lapse, morbidity, investment yield and maintenance expense assumptions. In addition, future policy benefit reserves for certain contracts also include amounts related to our deferred profit liability, as described above.

Retirement. The reserves for future policy benefits of our Retirement segment, which as of December 31, 2017, represented 23% of our total future policy benefit reserves, primarily relate to our non-participating life contingent group annuity and structured settlement products and are generally calculated using the net premium valuation methodology, as described above. The primary assumptions used in establishing these reserves include mortality, retirement, maintenance expense, and investment yield assumptions. In addition, future policy benefit reserves for certain contracts also include amounts related to our deferred profit liability, as described above.

Individual Annuities. The reserves for future policy benefits of our Individual Annuities segment, which as of December 31, 2017, represented 4% of our total future policy benefit reserves, primarily relate to reserves for the GMDB and GMIB features of our variable annuities, and for the optional living benefit features that are accounted for as embedded derivatives. As discussed above, in establishing reserves for GMDBs and GMIBs, we utilize current best estimate assumptions. The primary assumptions used in establishing these reserves generally include annuitization, lapse, withdrawal and mortality assumptions, as well as interest rate and equity market return assumptions. Lapse rates are adjusted at the contract level based on the in-the-moneyness of the living benefit and reflect other factors, such as the applicability of any surrender charges. Lapse rates are reduced when contracts are more in-the-money. Lapse rates are also generally assumed to be lower for the period where surrender charges apply.

The reserves for certain optional living benefit features, including GMAB, GMWB and GMIWB are accounted for as embedded derivatives at fair value, as described above. This methodology could result in either a liability or contra-liability balance, given changing capital market conditions and various actuarial assumptions. Since there is no observable active market for the transfer of these obligations, the valuations are calculated using internally-developed models with option pricing techniques. The models are based on a risk neutral valuation framework and incorporate premiums for risks inherent in valuation techniques, inputs, and the general uncertainty around the timing and amount of future cash flows. The significant inputs to the valuation models for these embedded derivatives include capital market assumptions, such as interest rate levels and volatility assumptions, the Company's market-perceived risk of its own non-performance risk ("NPR"), as well as actuarially determined assumptions, including mortality rates and contractholder behavior, such as lapse rates, benefit utilization rates and withdrawal rates. Capital market inputs and actual contractholders' account values are updated each quarter based on capital market conditions as of the end of the quarter, including interest rates, equity markets and volatility. In the risk neutral valuation, the initial swap curve drives the total returns used to grow the contractholders' account values. The Company's discount rate assumption is based on the LIBOR swap curve adjusted for an additional spread, which includes an estimate of NPR. Actuarial assumptions, including contractholder behavior and mortality, are reviewed at least annually, and updated based upon emerging experience, future expectations and other data, including any observable market data, such as available industry studies or market transactions such as acquisitions and reinsurance transactions. For additional information regarding the valuation of these optional living benefit features, see Note 20 to the Consolidated Financial Statements.

Individual Life. The reserves for future policy benefits of our Individual Life segment, which as of December 31, 2017, represented 5% of our total future policy benefit reserves, primarily relate to term life, universal life and variable life products. For term life contracts, the future policy benefit reserves are generally calculated using the net premium valuation methodology, as described above. The primary assumptions used in determining expected future benefits and expenses include mortality, lapse, and maintenance expense assumptions. For variable and universal life products, which include universal life contracts that contain no-lapse guarantees, reserves for future policy benefits are primarily established using the reserving methodology for GMDB and GMIB contracts. As discussed above, in establishing reserves for GMDBs and GMIBs, we utilize current best estimate assumptions. The primary assumptions used in establishing these reserves generally include mortality, lapse, and premium pattern, as well as interest rate and equity market return assumptions.

Group Insurance. The reserves for future policy benefits of our Group Insurance segment, which as of December 31, 2017, represented 2% of our total future policy benefit reserves, primarily relate to reserves for group life and disability benefits. For short-duration contracts, a liability is established when the claim occurs. The reserves for group life and disability benefits include our liability of $2.6 billion for unpaid claims and claim adjustment expenses for our Group Insurance segment as of December 31, 2017, which relates primarily to the group long-term disability product. This liability represents our estimate of future disability claim payments and expenses as well as estimates of claims that have been incurred, but have not yet been reported, as of the balance sheet date. The liability is determined as the present value of expected future claim payments and expenses. The primary assumptions used in determining expected future claim payments are claim termination factors, an assumed interest rate and expected Social Security offsets. Long-term disability claims and claim termination experience may be affected by the economic environment and internal factors such as our claims management process. The remaining reserves for future policy benefits for group life and disability benefits relate primarily to our group life business, and include reserves for Waiver of Premium, Claims In Course of Settlement and Claims Incurred But Not Reported. The Waiver of Premium reserve is calculated as the present value of future benefits, and utilizes assumptions such as expected mortality and recovery rates. The Claims In Course of Settlement reserve is based on the inventory of claims that have been reported but not yet paid. The Claims Incurred But Not Reported reserve is estimated using expected patterns of claims reporting.

Corporate and Other operations. The reserves for future policy benefits of our Corporate & Other operations, which as of December 31, 2017, represented 2% of our total future policy benefit reserves, primarily relate to our long-term care products and are generally calculated using the net premium valuation methodology, as described above. Most contracts have recorded a premium deficiency reserve, for which we use assumptions as of the most recent premium deficiency reserve establishment. The primary assumptions used in establishing these reserves include interest rate, morbidity, mortality, lapse, premium rate increase and maintenance expense assumptions. In addition, certain less significant reserves for our long-term care products, such as our disabled life reserves, are established using current best estimate actuarial assumptions.

Closed Block Division. The future policy benefit reserves for the traditional participating life insurance products of the Closed Block division, which as of December 31, 2017, represented 19% of our total future policy benefit reserves are determined using the net premium valuation methodology, as described above. Under this method, the future policy benefit reserves are accrued as a level proportion of the premium paid by the policyholder. In applying this method, we use mortality assumptions to determine our expected future benefits and expected future premiums, and apply an interest rate to determine the present value of both the expected future benefit payments and the expected future premiums. The mortality assumptions are based on standard industry mortality tables that were used to determine the cash surrender value of the policies, and the interest rates used are the interest rates used to calculate the cash surrender value of the policies.

Profits Followed by Losses

In certain instances, the policyholder liability for a particular line of business may not be deficient in the aggregate to trigger loss recognition, but the pattern of earnings may be such that profits are expected to be recognized in earlier years followed by losses in later years. In these situations, accounting standards require that an additional PFL liability be recognized by an amount necessary to sufficiently offset the losses that would be recognized in later years. The PFL liability is based on our current estimate of the present value of the amount necessary to offset losses anticipated in future periods. Because the liability is measured on a discounted basis, there will also be accretion into future earnings through an interest charge, and the liability will ultimately be released into earnings as an offset to future losses. This PFL liability is predominantly associated with certain universal life contracts that measure net GAAP reserves using current best estimate assumptions and accordingly, will be updated each quarter using current inforce and market data and as part of the annual assumption update.

Policyholders’ Account Balances

Unearned Revenue Reserve

Our unearned revenue reserve (“URR”), reported as a component of “Policyholders’ account balances,” was $2.4 billion as of December 31, 2017. This reserve primarily relates to variable and universal life products within our Individual Life and International Insurance segments and represents policy charges for services to be provided in future periods. The charges are deferred as unearned revenue and are generally amortized over the expected life of the contract in proportion to the product’s estimated gross profits, similar to DAC and DSI as discussed above.

Sensitivities for Insurance Assets and Liabilities

The following table summarizes the impact that could result on each of the listed financial statement balances for the specified segments relative to changes in certain assumptions that may be considered reasonably likely to occur. The information below is for illustrative purposes only and considers only the hypothetical direct impact on December 31, 2017 balances of changes in a single assumption and not changes in any combinations of assumptions. The figures below are presented for segments that are expected to experience a significant impact as a result of the corresponding assumption change. Changes in excess of those illustrated may occur in any period. A description of the estimates and assumptions used in the preparation of each of these financial statement balances is provided further above. For traditional long duration contracts and limited payment contracts, U.S. GAAP requires the original assumptions used when the contracts are issued to be locked-in and that those assumptions be used in all future liability calculations as long as the resulting liabilities are adequate to provide for the future benefits and expenses (i.e., there is no premium deficiency). Therefore, these products are not reflected in the sensitivity table below unless the hypothetical change in assumption would cause a premium deficiency.

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The impacts presented within this table do not reflect the related impacts of our asset liability management strategy which seeks to offset the changes in the balances presented within this table and is primarily comprised of investments and derivatives. See further below for a discussion of the estimates and assumptions involved with the application of U.S. GAAP accounting policies for these instruments and “Quantitative and Qualitative Disclosures about Market Risk” for hypothetical impacts on related balances as a result of changes in certain significant assumptions.

	December 31, 2017		
	Increase (Decrease) in Deferred Policy Acquisition Costs, Deferred Sales Inducements and Value of Business Acquired	Future Policy Benefits and Policyholders’ Account Balances(1)	Net Impact
	(in millions)		
Assumptions:			
Long-term interest rate(2):			
Increase by 25 basis points	$55	$ (45)	$100
Decrease by 25 basis points	$(60)	$ 50	$(110)
Long-term equity expected rate of return(3):			
Increase by 50 basis points	$100	$ (45)	$145
Decrease by 50 basis points	$(200)	$ 60	$(260)
NPR credit spread(4):			
Increase by 50 basis points	$(350)	$ (1,715)	$1,365
Decrease by 50 basis points	$385	$ 1,890	$(1,505)
Mortality(5):			
Increase by 1%	$(85)	$ (105)	$20
Decrease by 1%	$85	$ 105	$(20)
Lapse(6):			
Increase by 10%	$(165)	$ (750)	$585
Decrease by 10%	$175	$ 780	$(605)

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(1) Includes GMDB/GMIB reserves, embedded derivative liabilities for certain living benefit guaranteed features, PFL liability, and URR.

(2) Represents the impact of a parallel shift in the long-term interest rate yield curve for the Individual Life segment and the Japanese insurance operations.

(3)

Represents the impact of an increase or decrease in the long-term equity expected rate of return for the Individual Annuities segment.

(4) Represents the impact of an increase or decrease in the NPR credit spread for the Individual Annuities segment.

(5) Represents the impact of an increase or decrease in mortality rates for the Individual Life and Individual Annuities segments.

(6) Represents the impact of an increase or decrease in lapse rates for the Individual Life and Individual Annuities segments, and the Long-Term Care business within our Corporate and Other operations.

Goodwill

As of December 31, 2017, our goodwill balance of $843 million is reflected in the following four reporting units: $444 million related to our Retirement Full Service business, $235 million related to our Investment Management business, $152 million related to our Gibraltar Life and Other operations and $12 million related to our International Insurance Life Planner business.

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We test goodwill for impairment on an annual basis, as of December 31 of each year, or more frequently if events or circumstances indicate the potential for impairment is more likely than not. The goodwill impairment analysis is performed at the reporting unit level which is equal to or one level below our operating segments. Accounting guidance provides for an optional qualitative assessment for testing goodwill impairment that may allow companies to skip the quantitative two step test. For additional information on goodwill and the process for testing goodwill for impairment, see Note 2 and Note 9 to the Consolidated Financial Statements.

In the International Insurance Life Planner business and the Gibraltar Life and Other operations as well as the Investment Management segment, we did not elect to utilize the option for qualitative analysis and therefore completed a quantitative impairment analysis using an earnings multiple approach. The earnings multiple approach indicates the value of a business based on comparison to publicly-traded comparable companies in similar lines of business. Each comparable company is analyzed based on various factors, including, but not limited to, financial risk, size, geographic diversification, profitability, adequate financial data, and an actively traded stock price. A multiple of price to earnings is developed for the comparable companies using independent analysts' consensus estimates for each company's 2018 forecasted earnings. The multiples are then aggregated and a mean and median multiple is calculated for the group. The lower of the mean or median multiple is then applied to the 2018 forecasted earnings of the reporting unit to develop a value. A control premium is then added to determine a total estimated fair value for the reporting unit.

In the Retirement Full Service business, we also did not elect to utilize the option for qualitative analysis and therefore completed a quantitative impairment analysis using a discounted cash flow approach. The discounted cash flow approach calculates the value of a business by applying a discount rate reflecting the market expected rate of return of the reporting unit to its projected future cash flows. These projected future cash flows were based on our internal forecasts, an expected growth rate and a terminal value. The reporting unit expected rate of return represents the required rate of return on its total capitalization. The process of deriving reporting unit specific required rates of return begins with the calculation of an overall Company Weighted Average Cost of Capital, which includes the calculation of the required return on equity using a Capital Asset Pricing Model ("CAPM"). The CAPM is a generally accepted method for estimating an equity investor's return requirement, and hence a company's cost of equity capital. The calculation using the CAPM begins with the long-term risk-free rate of return, then applies a market risk premium for large company common stock, as well as company specific adjustments to address volatility versus the market. The Company then determines reporting unit specific required rates of return based on their relative volatilities, benchmarks results against reporting unit comparable companies, and ensures that the sum of the reporting unit required returns (after considering the impact of unallocated Corporate costs and capital) add up to the overall Company required return. This process results in reporting unit specific discount rates which are then applied to the expected future cash flows of the Retirement Full Service business to estimate fair value.

After completion of the first step of the quantitative tests, the fair values exceeded the carrying amounts for each of the four reporting units and we concluded there was no impairment as of December 31, 2017. The Investment Management, International Insurance Life Planner, Gibraltar Life and Other operations, and Retirement Full Service businesses had estimated fair values that exceeded their carrying amounts, each by at least 55%. Completion of the second step of the quantitative analysis is therefore not necessary.

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

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

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

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

We present at fair value in the statements of financial position our investments classified as available-for-sale (including fixed maturity and equity securities), investments classified as trading such as our trading account assets supporting insurance liabilities, derivatives and embedded derivatives. For additional information regarding the key estimates and assumptions surrounding the determination of fair value of fixed maturity and equity securities, as well as derivative instruments, embedded derivatives and other investments, see Note 20 to the Consolidated Financial Statements and "—Valuation of Assets and Liabilities—Fair Value of Assets and Liabilities."

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

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

Pension and Other Postretirement Benefits

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

We determine our expected rate of return on plan assets based upon a building block approach that considers inflation, real return, term premium, credit spreads, equity risk premium and capital appreciation as well as expenses, the effect of active management and the effect of rebalancing for the equity, debt and real estate asset mix applied on a weighted average basis to our pension asset portfolio. See Note 18 to our Consolidated Financial Statements for our actual asset allocations by asset category and the asset allocation ranges prescribed by our investment policy guidelines for both our pension and other postretirement benefit plans. Our assumed long-term rate of return for 2017 was 6.25% for our domestic pension plans and 7.00% for our other postretirement benefit plans. Given the amount of plan assets as of December 31, 2016, the beginning of the measurement year, if we had assumed an expected rate of return for both our domestic pension and other domestic postretirement benefit plans that was 100 bps higher or 100 bps lower than the rates we assumed, the change in our net periodic costs would have been as shown in the table below. The information provided in the table below considers only changes in our assumed long-term rate of return given the level and mix of invested assets at the beginning of the measurement year, without consideration of possible changes in any of the other assumptions described above that could ultimately accompany any changes in our assumed long-term rate of return.

	For the year ended December 31, 2017	
	Increase/(Decrease) in Net Periodic Pension Cost	Increase/(Decrease) in Net Periodic Other Postretirement Cost
	(in millions)	

Increase in expected rate of return by 100 bps	$ (122)	$ (15)
Decrease in expected rate of return by 100 bps	$ 122	$ 15

Foreign pension plans represent 5% of plan assets at the beginning of 2017. An increase in expected rate of return by 100 bps would result in a decrease in net periodic pension costs of $6 million; conversely, a decrease in expected rate of return by 100 bps would result in an increase in net periodic pension costs of $5 million.

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We determine our discount rate, used to value the pension and postretirement benefit obligations, based upon rates commensurate with current yields on high quality corporate bonds. See Note 18 to the Consolidated Financial Statements for information regarding the December 31, 2016 methodology we employed to determine our discount rate for 2017. Our assumed discount rate for 2017 was 4.15% for our domestic pension plans and 4.05% for our other domestic postretirement benefit plans. Given the amount of pension and postretirement obligations as of December 31, 2016, the beginning of the measurement year, if we had assumed a discount rate for both our domestic pension and other postretirement benefit plans that was 100 bps higher or 100 bps lower than the rates we assumed, the change in our net periodic costs would have been as shown in the table below. The information provided in the table below considers only changes in our assumed discount rate without consideration of possible changes in any of the other assumptions described above that could ultimately accompany any changes in our assumed discount rate.

	For the year ended December 31, 2017	
	Increase/(Decrease) in Net Periodic Pension Cost	Increase/(Decrease) in Net Periodic Other Postretirement Cost
	(in millions)	
Increase in discount rate by 100 bps	$ (111)	$ (7)
Decrease in discount rate by 100 bps	$ 140	$ 5

Foreign pension plans represent 14% of plan obligations at the beginning of 2017. An increase in discount rate by 100 bps would result in a decrease in net periodic pension costs of $26 million; conversely, a decrease in discount rate by 100 bps would result in an increase in net periodic pension costs of $9 million.

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

For a discussion of our expected rate of return on plan assets and discount rate for our qualified pension plan in 2017, see "—Results of Operations by Segment—Corporate and Other."

For purposes of calculating pension income from our own qualified pension plan for the year ended December 31, 2018, we will decrease the discount rate to 3.65% from 4.15% in 2017. The expected rate of return on plan assets will remain unchanged at 6.25%, and the assumed rate of increase in compensation will remain unchanged at 4.5%.

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

At December 31, 2017, the sensitivity of our domestic and foreign pension and postretirement obligations to a 100 basis point change in discount rate was as follows:

	December 31, 2017	
	Increase/(Decrease) in Pension Benefits Obligation	Increase/(Decrease) in Accumulated Postretirement Benefits Obligation
	(in millions)	

Increase in discount rate by 100 bps	$ (1,437)	$ (187)
Decrease in discount rate by 100 bps	$ 1,653	$ 208

Taxes on Income

Our effective tax rate is based on income, non-taxable and non-deductible items, statutory tax rates and tax planning opportunities available in the various jurisdictions in which we operate. Inherent in determining our annual tax rate are judgments regarding business plans, planning opportunities and expectations about future outcomes. The DRD is a major reason for the difference between the Company's effective tax rate and the federal statutory rate. The DRD is an estimate that incorporates the prior and current year information, as well as the current year's equity market performance. Both the current estimate of the DRD and the DRD in future periods can vary based on factors such as, but not limited to, changes in the amount of dividends received

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that are eligible for the DRD, changes in the amount of distributions received from underlying fund investments, changes in the account balances of variable life and annuity contracts, and the Company's taxable income before the DRD.

In December 2017, SEC staff issued "SAB 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act" ("SAB 118"), which allows the registrants to record provisional amounts during a 'measurement period' not to extend beyond one year. Under the relief provided by SAB 118, a company can recognize provisional amounts when it does not have the necessary information available, prepared or analyzed in reasonable detail to complete its accounting for the change in tax law. See Note 19 to the Consolidated Financial Statements for a discussion of provisional amounts related to the Tax Act of 2017 included in "Total income tax expense (benefit) before equity in earnings of operating joint ventures" in 2017.

The Tax Act of 2017 includes a provision causing post-1986 unremitted foreign earnings of at least 10% owned non-U.S. affiliates to be included in the Company's U.S. income tax base, with an election to pay the associated tax on an eight-year installment basis. Unremitted foreign earnings from certain operations in foreign jurisdictions that impose a withholding tax on dividends are considered to be permanently reinvested for purposes of determining the applicable withholding tax expense. See Note 19 to the Consolidated Financial Statements for a discussion of unremitted earnings for which the Company provides U.S. income taxes.

An increase or decrease in our effective tax rate by one percentage point would have resulted in a decrease or increase in our 2017 "Total income tax expense (benefit)" of $65 million.

Contingencies

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

Other Accounting Policies

Accounting for Certain Reinsurance Contracts in our Individual Life business

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

Adoption of New Accounting Pronouncements

There are no new critical accounting estimates resulting from new accounting pronouncements adopted during 2017. See Note 2 to the Consolidated Financial Statements for a complete discussion of newly adopted accounting pronouncements and accounting pronouncements issued but not yet adopted.

Results of Operations by Segment

U.S. Individual Solutions Division

Individual Annuities

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

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

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

Operating Results

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

	Year ended December 31,		
	2017	2016	2015
	(in millions)		
Operating results:			
Revenues	$5,110	$4,666	$4,695
Benefits and expenses	2,912	2,901	2,898
Adjusted operating income	2,198	1,765	1,797
Realized investment gains (losses), net, and related adjustments	(1,157)	2,031	1,588
Related charges	577	68	(624)
Income (loss) before income taxes and equity in earnings of operating joint ventures	$1,618	$3,864	$2,761

Adjusted Operating Income

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

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The impacts of changes in the estimated profitability of the business include adjustments to the amortization of DAC and other costs as well as to the reserves for certain living and/or death benefit features of our variable annuity products. These adjustments resulted in a net benefit of $183 million and $138 million in 2017 and 2016, respectively. The net benefits primarily reflected the net impact of equity market performance on contractholder accounts and hedge effectiveness relative to our assumptions, as well as a net benefit resulting from our annual reviews and update of assumptions and other refinements.

2016 to 2015 Annual Comparison. Adjusted operating income decreased $32 million. Excluding the impacts of changes in the estimated profitability of the business, discussed below, adjusted operating income decreased $8 million. The decrease was primarily driven by lower asset-based fee income, net of associated costs, as well as higher general and administrative expenses including business growth initiatives. The decrease in asset-based fee income, net of a related decrease in asset-based commissions, was driven by a decline in average variable annuity account values and the decrease in the average effective fee rate as fee rates on recent sales are generally lower than fee rates on the inforce block. This decrease was partially offset by an increase due to greater efficiency in managing product risks associated with a recently implemented asset-liability management strategy discussed below. Partially offsetting this net decline were increases in net investment income driven by higher income on non-coupon investments and higher invested assets, as well as lower amortization costs and lower interest expense. This net decline was also partially offset by the absence of certain costs for contract cancellations incurred in 2015.

Adjustments to the amortization of DAC and other costs and to the reserves for certain living and/or death benefit features of our variable annuity products resulted in a net benefit of $138 million and $162 million in 2016 and 2015, respectively. The net benefits primarily reflected the net impact of equity market performance on contractholder accounts and hedge effectiveness (beginning in the third quarter of 2016 as a result of our new ALM strategy) relative to our assumptions, as well as a net benefit resulting from our annual reviews and update of assumptions and other refinements.

Revenues, Benefits and Expenses

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

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

2016 to 2015 Annual Comparison. Revenues decreased $29 million. Excluding a $5 million net decrease related to the impacts of certain changes in our estimated profitability of the business, as discussed above, revenues decreased $24 million, driven by a decrease in policy charges and fee income, asset management and service fees and other income, primarily due to a decline in average variable annuity account values. Partially offsetting this decrease was an increase in net investment income driven by higher income on non-coupon investments and higher invested assets, and an increase in premiums reflecting an increase in annuitizations of our variable annuity contracts, with offsets in policyholders’ benefits, as discussed below.

Benefits and expenses increased $3 million. Excluding a $19 million net increase related to the impacts of certain changes in our estimated profitability of the business, as discussed above, benefits and expenses decreased $16 million. Interest credited to policyholders' account balances and amortization of DAC decreased $21 million and $12 million, respectively, driven by lower fee income, as discussed above. General and administrative expenses, net of capitalization, decreased $10 million driven by lower asset management costs and lower asset-based commissions due to lower average account values, partially offset by higher operating expenses. Partially offsetting these decreases was a $25 million increase in policyholders' benefits, including changes in reserves, primarily reflecting an increase in annuitizations of our variable annuity contracts with offsets in premiums, as discussed above.

Account Values

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

	Year ended December 31,		
	2017	2016	2015
	(in millions)		
Total Individual Annuities(1):			
Beginning total account value	$156,783	$152,945	$158,664
Sales	5,894	8,054	8,780
Surrenders and withdrawals	(9,821)	(7,881)	(8,415)
Net sales	(3,927)	173	365
Benefit payments	(1,873)	(1,794)	(1,910)
Net flows	(5,800)	(1,621)	(1,545)
Change in market value, interest credited and other activity	21,355	9,012	(585)
Policy charges	(3,712)	(3,553)	(3,589)
Ending total account value	$168,626	$156,783	$152,945

(1) Includes variable and fixed annuities sold as retail investment products. Investments sold through defined contribution plan products are included with such products within the Retirement segment. Variable annuity account values were $165.1 billion, $153.3 billion and $149.4 billion as of December 31, 2017, 2016 and 2015, respectively. Fixed annuity account values were $3.5 billion as of December 31, 2017, 2016 and 2015.

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

2016 to 2015 Annual Comparison. The increase in account values during 2016 was largely driven by favorable changes in the market value of contractholder funds, partially offset by contract charges on contractholder accounts and benefit payments. Net sales for 2016 decreased compared to 2015 reflecting lower gross sales partially offset by lower surrenders and withdrawals. The decline in gross sales for 2016 compared to 2015 was largely driven by decreased sales of our Prudential Premier® Retirement Variable Annuity with "highest daily" benefit riders and Prudential Premier® Investment Variable Annuity ("PPI"). The declines in gross sales were partially offset by increases in sales of our Prudential Defined Income Variable Annuity ("PDI") product.

Variable Annuity Risks and Risk Mitigants

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

Product Design Features

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A portion of the variable annuity contracts that we offer include an automatic rebalancing feature, also referred to as an asset transfer feature. This feature is implemented at the contract level, and transfers assets between certain variable investment sub-accounts selected by the annuity contractholder and, depending on the benefit feature, a fixed-rate account in the general account or a bond fund sub-account within the separate accounts. The automatic rebalancing feature associated with currently-sold highest daily benefit products uses a designated bond fund sub-account within the separate accounts. The transfers are based on a static mathematical formula used with the particular benefit which considers a number of factors, including, but not limited to, the impact of investment performance on the contractholder’s total account value. The objective of the automatic rebalancing feature is to reduce our exposure to equity market risk and market volatility. Other product design features we utilize include, among others, asset allocation restrictions, minimum issuance age requirements and certain limitations on the amount of contractholder deposits, as well as a required minimum allocation to our general account for certain of our products. We continue to introduce products that diversify our risk profile and have incorporated provisions in product design allowing frequent revisions of key pricing elements for certain of our products. In addition, there is diversity in our fee arrangements, as certain fees are primarily based on the benefit guarantee amount, the contractholder account value and/or premiums, which helps preserve certain revenue streams when market fluctuations cause account values to decline.

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

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

During the third quarter of 2016, we implemented a new ALM strategy that utilizes a combination of both traditional fixed income instruments and derivatives to help defray potential claims associated with our variable annuity living benefit guarantees. The economic liability we manage with this ALM strategy consists of expected living benefit claims under less severe market conditions, which are managed through the accumulation of fixed income instruments, and potential living benefit claims resulting from more severe market conditions, which are hedged using derivative instruments. For the portion of our ALM strategy executed with derivatives, we enter into a range of exchange-traded, cleared, and OTC equity and interest rate derivatives, including, but not limited to: equity and treasury futures; total return and interest rate swaps; and options, including equity options, swaptions, and floors and caps. The intent of this strategy is to more efficiently manage the capital and liquidity associated with these products while continuing to mitigate fluctuations in net income due to movements in capital markets.

The change in hedge strategy had no impact on how we value or account for the living benefit guarantees under U.S. GAAP. However, under the ALM strategy that began in the third quarter of 2016, adjusted operating income includes the fees earned that are in excess of the estimated portion of fees required to cover expected claims and hedge costs for the economic liability. The portion of fees required to cover such costs is updated quarterly to reflect updated estimates and actual experience. The effectiveness of our hedging program as measured by comparing the change in value of our hedging assets to the change in value of the liability we are attempting to hedge will ultimately be reflected in adjusted operating income over time through the inclusion of actual hedge costs. Expected costs are updated periodically along with our expectation of claims. For adjusted operating income purposes, DAC and other costs are fully amortized over the life of the contracts proportional to our actual and estimated gross profits under the adjusted operating income framework described above. Overall, we generally expect this strategy to result in a higher portion of fees being recognized in adjusted operating income than under our prior strategy.

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

	As of December 31,	
	2017	2016
	(in millions)	
U.S. GAAP liability (including non-performance risk)	$8,663	$8,179
Non-performance risk adjustment	3,228	7,136
Subtotal	11,891	15,315
Adjustments including risk margins and valuation methodology differences	(2,742)	(5,663)
Economic liability managed through the ALM strategy	$9,149	$9,652

As of December 31, 2017, our fixed income instruments and derivative assets exceed the economic liability within the entities in which the risks reside.

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

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

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

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

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

	Year ended December 31,		
	2017	2016	2015
	(in millions)(1)		
Excluding impact of assumption updates and other refinements:			
Net hedging impact(2)(3)	$620	$(692)	$(547)
Change in portions of U.S. GAAP liability, before NPR(4)	2,477	1,745	(67)
Change in the NPR adjustment	(3,890)	(1,097)	2,243
Net impact from changes in the U.S. GAAP embedded derivative and hedge positions-reported in Individual Annuities	(793)	(44)	1,629
Related benefit (charge) to amortization of DAC and other costs	$159	$243	$(701)
Net impact of assumption updates and other refinements	(85)	1,455	(34)
Net impact from changes in the U.S. GAAP embedded derivative and hedge positions, after the impact of NPR, DAC and other costs-reported in Individual Annuities(3)	$(719)	$1,654	$894

(1) Positive amount represents income; negative amount represents a loss.
(2) Net hedging impact represents the difference between the change in fair value of the risk we seek to hedge using derivatives and the change in fair value of the derivatives utilized with respect to that risk.

(3) Excludes $0 million, $(1,523) million and $(585) million for 2017, 2016 and 2015, respectively, representing the impact of managing interest rate risk through capital management strategies other than hedging of particular exposures through September 30, 2016. Because this decision was based on the capital considerations of the Company as a whole, the impact was reported in Corporate and Other operations. See “—Corporate and Other.”

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

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

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

The net gain of $894 million for 2015 primarily reflected a $2,243 million net benefit from the change in the NPR adjustment, driven by net increases in the base embedded derivative liability before NPR primarily due to declining interest rates and widening credit spreads. This impact was partially offset by a $547 million net charge from changes in the value of our historically defined hedge target, and related hedge positions, primarily driven by fund underperformance relative to indices and unfavorable liability basis. Each of these items resulted in partial offsets included in the $701 million related charge to the amortization of DAC and other costs. The net charge from the impact of assumption updates and other refinements of $34 million resulted from our annual review and update of assumptions, primarily driven by modifications to our actuarial assumptions and other refinements. Results also reflected the changes in the portions of the U.S. GAAP liability that are excluded from our historically defined hedge target, net of related impacts to the amortization of DAC and other costs.

For information regarding the Capital Protection Framework we use to evaluate and support the risks of the ALM strategy, see "—Liquidity and Capital Resources—Capital."

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

Capital Hedge Program

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

External Reinsurance

As of December 31, 2017, $3.2 billion of HDI v.3.0 account values are reinsured to Union Hamilton Reinsurance Ltd., an external counterparty, pursuant to a quota share agreement that covered approximately 50% of new business between April 1, 2015 and December 31, 2016. HDI v.3.0 is the current version of our "highest daily" living benefits guarantee that is available with our Prudential Premier® Retirement Variable Annuity. New sales of HDI v.3.0 subsequent to December 31, 2016 are not covered by this external reinsurance agreement.

Product Specific Risks and Risk Mitigants

For certain living benefits guarantees, claims will primarily represent the funding of contractholder lifetime withdrawals after the cumulative withdrawals have first exhausted the contractholder account value. Due to the age of the in force block, limited claim payments have occurred to date, and they are not expected to increase significantly within the next five years, based upon current assumptions. The timing and amount of future claims will depend on actual returns on contractholder account value and actual contractholder behavior relative to our assumptions. The majority of our current living benefits guarantees provide for guaranteed lifetime contractholder withdrawal payments inclusive of a "highest daily" contract value guarantee. Our PDI variable annuity complements our variable annuity products with the highest daily benefit and provides for guaranteed lifetime contractholder withdrawal payments, but restricts contractholder asset allocation to a single bond fund sub-account within the separate accounts.

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

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

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

	December 31,					
	2017		2016		2015	
	Account Value	% of Total	Account Value	% of Total	Account Value	% of Total
	(in millions)					
Living benefit/GMDB features(1):						
Both ALM strategy and automatic rebalancing(2)	$114,686	69 %	$106,585	69 %	$106,018	71 %
ALM strategy only	9,317	6 %	9,409	6 %	9,994	7 %
Automatic rebalancing only	1,003	1 %	1,168	1 %	1,393	1 %
External reinsurance(3)	3,227	2 %	2,932	2 %	1,513	1 %
PDI	9,996	5 %	7,926	5 %	4,664	3 %
Other Products	2,791	2 %	2,730	2 %	2,870	2 %
Total living benefit/GMDB features	$141,020		$130,750		$126,452	
GMDB features and other(4)	24,133	15 %	22,545	15 %	22,989	15 %
Total variable annuity account value	$165,153		$153,295		$149,441	

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

Individual Life

Operating Results

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

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	Year ended December 31,		
	2017	2016	2015
	(in millions)		
Operating results:			
Revenues	$4,974	$5,355	$5,233
Benefits and expenses	5,165	5,276	4,598
Adjusted operating income	(191)	79	635
Realized investment gains (losses), net, and related adjustments	96	58	166
Related charges	101	(223)	(9)
Income (loss) before income taxes and equity in earnings of operating joint ventures	$6	$(86)	$792

Adjusted Operating Income

2017 to 2016 Annual Comparison. Adjusted operating income decreased $270 million, primarily reflecting unfavorable comparative net impacts from our annual reviews and update of assumptions and other refinements. Results for 2017 included a $653 million net charge from this annual review, mainly driven by a charge related to the unfavorable impacts for universal life and variable life products from modeling enhancements and other refinements related to a valuation systems conversion, including a net charge related to a change in the method of accounting for reinsurance associated with certain long-duration insurance contracts (see "—Accounting Policies & Pronouncements—Application of Critical Accounting Estimates—Other Accounting Policies—Accounting for Certain Reinsurance Contracts in our Individual Life business"), as well as unfavorable lapse rate assumptions primarily for universal life products. Results for 2016 included a $420 million net charge from our annual reviews and update of assumptions and other refinements, mainly driven by a charge to accrue a liability to offset the present value of losses expected to be recognized in later years (see "Profits Followed by Losses" included in "—Accounting Policies & Pronouncements" above) and a charge related to an out of period adjustment (see Note 1 to the Consolidated Financial Statements), partially offset by a net benefit from the impacts of other refinements. Excluding these impacts, adjusted operating income decreased $37 million, primarily reflecting the unfavorable ongoing impact of our second quarter 2017 annual review and update of assumptions and other refinements, higher general and administrative expenses, including expenses related to business growth initiatives, and an unfavorable impact from mortality experience, net of reinsurance. These decreases were partially offset by a higher contribution from net investment spread results.

2016 to 2015 Annual Comparison. Adjusted operating income decreased $556 million, primarily reflecting unfavorable comparative net impacts from our annual reviews and update of assumptions and other refinements. Results for 2016 included a $420 million net charge from these impacts, as discussed above. Results for 2015 included a $68 million net benefit from our annual review and update of assumptions and other refinements, mainly driven by net favorable modifications to our economic and actuarial assumptions. Excluding these impacts, adjusted operating income decreased $68 million, primarily driven by less favorable mortality experience, net of reinsurance, and higher general and administrative expenses driven by business growth initiatives, partially offset by a higher contribution from investment results.

Revenues, Benefits and Expenses

2017 to 2016 Annual Comparison. Revenues decreased $381 million. Excluding the impact of our annual reviews and update of assumptions and other refinements, as discussed above, revenues increased $152 million. Net investment income increased $126 million primarily reflecting higher average invested assets resulting from continued business growth and higher investment income from unaffiliated reserve financing activity, which resulted in a corresponding increase in interest expense, as discussed below, and higher income on non-coupon investments, partially offset by lower prepayment fee income. Premiums increased $35 million primarily driven by growth in our term life insurance business. Policy charges and fee income, asset management and service fees and other income decreased $9 million, reflecting higher cost of reinsurance premiums, as a result of the unfavorable ongoing impact of the second quarter 2017 change in the method of accounting for reinsurance (partial offsets included in benefits and expenses below), partially offset by an increase in asset management and service fees and other income from continued business growth.

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Benefits and expenses decreased $111 million. Excluding the impact of our annual reviews and update of assumptions and other refinements, as discussed above, benefits and expenses increased $189 million. General and administrative expenses, net of capitalization, increased $66 million primarily reflecting higher operating expenses including business growth initiatives. Interest expense increased $65 million related to higher reserve financing costs, as discussed above. Policyholders' benefits and interest credited to account balances increased $58 million, reflecting continued business growth and an unfavorable impact from mortality experience, partially offset by the favorable ongoing impact of the second quarter 2017 change in the method of accounting for reinsurance, as discussed above.

2016 to 2015 Annual Comparison. Revenues increased $122 million. Excluding the impact of our annual reviews and update of assumptions and other refinements, as discussed above, revenues increased $199 million. Net investment income increased $153 million primarily reflecting higher invested assets resulting from continued business growth and higher required capital, higher prepayment fee income and higher income on non-coupon investments. Policy charges and fee income, asset management and service fees and other income increased $82 million, primarily driven by growth in universal life business, partially offset by a decrease in the amortization of unearned revenue reserves, driven by the impact of changes in the estimated profitability of the business due to experience relative to our assumptions. Partially offsetting these increases was a $36 million decrease in premiums, primarily driven by higher ceded reinsurance premiums which were mostly offset by reserve changes in Policyholders' benefits.

Benefits and expenses increased $678 million. Excluding the impact of our annual reviews and update of assumptions and other refinements, as discussed above, benefits and expenses increased $267 million. Policyholders' benefits and interest credited to account balances increased $195 million primarily reflecting universal life business growth and less favorable mortality experience, partially offset by reserve changes for ceded reinsurance premiums discussed above. General and administrative expenses, net of capitalization, increased $40 million primarily driven by business growth and initiatives. Interest expense increased $33 million related to higher reserve financing costs.

Sales Results

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

	2017			2016			2015		
	Prudential Advisors	Third Party	Total	Prudential Advisors	Third Party	Total	Prudential Advisors	Third Party	Total
	(in millions)								
Term Life	$30	$183	$213	$32	$168	$200	$33	$171	$204
Guaranteed Universal Life(1)	16	140	156	24	219	243	31	189	220
Other Universal Life(1)	37	88	125	34	61	95	28	61	89
Variable Life	35	95	130	26	66	92	22	56	78
Total	$118	$506	$624	$116	$514	$630	$114	$477	$591

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(1) Single pay life premiums and excess (unscheduled) premiums are included in annualized new business premiums based on a 10% credit and represented approximately 15%, 13% and 17% of Guaranteed Universal Life and 1%, 3% and 7% of Other Universal Life annualized new business premiums for the years ended December 31, 2017, 2016 and 2015, respectively.

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

2016 to 2015 Annual Comparison. Annualized new business premiums increased $39 million, primarily driven by the continued impact of product enhancements in both universal and variable life as well as continued improvements in distribution execution.

U.S. Workplace Solutions Division

Retirement

Operating Results

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

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	Year ended December 31,		
	2017	2016	2015
	(in millions)		
Operating results(1):			
Revenues	$13,843	$12,876	$11,821
Benefits and expenses	12,599	11,864	10,890
Adjusted operating income	1,244	1,012	931
Realized investment gains (losses), net, and related adjustments	(62)	(281)	255
Related charges	(90)	(272)	(1)
Investment gains (losses) on trading account assets supporting insurance liabilities, net	118	(21)	(581)
Change in experience-rated contractholder liabilities due to asset value changes	67	25	490
Income (loss) before income taxes and equity in earnings of operating joint ventures	$1,277	$463	$1,094

(1) Certain of our Retirement segment's non-U.S. dollar-denominated earnings are from longevity reinsurance contracts, which are denominated in British pounds sterling, and are therefore subject to foreign currency exchange rate risk. Effective January 1, 2016, the financial results of our Retirement segment include the impact of an intercompany arrangement with our Corporate and Other operations designed to mitigate the impact of exchange rate changes on the segment's U.S. dollar-equivalent earnings. For more information related to this intercompany arrangement, see "—Results of Operations—Impact of Foreign Currency Exchange Rates," above.

Adjusted Operating Income

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

2016 to 2015 Annual Comparison. Adjusted operating income increased $81 million. Results for 2016 reflected a net benefit of $6 million from our annual review and update of assumptions and other refinements, driven by favorable updates to actuarial assumptions, while results for 2015 reflected no net impact from our annual review and update of assumptions. Excluding this favorable comparative impact, adjusted operating income increased $74 million, primarily driven by higher net investment spread results, partially offset by a lower contribution from reserve experience, higher general and administrative expenses, net of capitalization, and lower fee income. The increase in net investment spread results primarily reflected higher net prepayment fee income, higher invested assets and income on non-coupon investments, partially offset by lower reinvestment rates net of crediting rate reductions on full service general account stable value products. The lower contribution from reserve experience primarily reflected lower mortality gains on a comparative basis for pension risk transfer contracts. The increase in general and administrative expenses, net of capitalization, was primarily driven by increased legal costs. The decrease in fee income primarily reflected lower margins on full service account values. This decrease was partially offset by growth in average account values and an increase in per participant fee charges.

Revenues, Benefits and Expenses

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

Benefits and expenses increased $735 million. Excluding the impact of our annual reviews and update of assumptions and other refinements, as discussed above, benefits and expenses increased $709 million. Policyholders' benefits, including the change in policy reserves, increased $705 million, primarily related to the increase in premiums discussed above.

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2016 to 2015 Annual Comparison. Revenues increased $1,055 million. Premiums increased $851 million primarily driven by pension risk transfer transactions. This increase in premiums resulted in a corresponding increase in policyholders' benefits, as discussed in benefits and expenses below. Net investment income increased $181 million, primarily reflecting higher invested assets, higher prepayment fee income and income on non-coupon investments, partially offset by lower reinvestment rates.

Benefits and expenses increased $974 million. Excluding the impact of our annual review and update of assumptions, as discussed above, benefits and expenses increased $981 million. Policyholders' benefits, including the change in policy reserves, increased $968 million, primarily related to the increase in premiums discussed above. Interest credited to policyholders' account balances increased $32 million, primarily driven by higher prepayment fee income credited to experience rated account balances and growth in account values as discussed below, partially offset by the impact of crediting rate reductions on full service general account stable value account values.

Account Values

Account values are a significant driver of our operating results, and are primarily driven by net additions (withdrawals) and the impact of market changes. The income we earn on most of our fee-based products varies in part with the level of fee-based account values, since many policy fees are determined by these values. The investment income and interest we credit to policyholders on our spread-based products varies with the level of general account values. To a lesser extent, changes in account values impact our pattern of amortization of DAC and VOBA and general and administrative expenses. The following table shows the changes in the account values and net additions (withdrawals) of Retirement segment products for the periods indicated. Net additions (withdrawals) are plan sales and participant deposits or additions, as applicable, minus plan and participant withdrawals and benefits. Account values include both internally- and externally-managed client balances as the total balances drive revenue for the Retirement segment. For more information on internally-managed balances, see "—Investment Management."

	Year ended December 31,		
	2017	2016	2015
	(in millions)		
Full Service:			
Beginning total account value	$202,802	$188,961	$184,196
Deposits and sales	29,527	21,928	25,684
Withdrawals and benefits	(24,811)	(20,127)	(21,559)
Change in market value, interest credited and interest income and other activity	27,098	12,040	640
Ending total account value	$234,616	$202,802	$188,961
Net additions (withdrawals)	$4,716	$1,801	$4,125
Institutional Investment Products:			
Beginning total account value	$183,376	$179,964	$179,641
Additions(1)	21,630	16,140	15,572
Withdrawals and benefits	(17,406)	(12,161)	(15,388)
Change in market value, interest credited and interest income	5,190	5,299	3,476
Other(2)	1,702	(5,866)	(3,337)
Ending total account value	$194,492	$183,376	$179,964
Net additions (withdrawals)	$4,224	$3,979	$184

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

(2)

“Other” activity includes the effect of foreign exchange rate changes associated with our U.K. longevity reinsurance business and changes in asset balances for externally-managed accounts. For the years ended December 31, 2017 and 2016, “other” activity also includes $4,782 million in receipts offset by $4,375 million in payments and $2,914 million in receipts offset by $2,364 million in payments, respectively, related to funding agreements backed by commercial paper which typically have maturities of less than 90 days.

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

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

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2016 to 2015 Annual Comparison. The increase in full service account values primarily reflected the favorable changes in the market value of customer funds. The decrease in net additions was primarily driven by lower large plan sales. This decrease was partially offset by lower plan lapses, as well as net participant deposits in 2016 compared to net participant withdrawals in 2015.

The increase in institutional investment products account values primarily reflected net additions resulting from investment-only stable value accounts and pension risk transfer transactions. The increase in net additions was primarily driven by investment-only stable value accounts, which reflected net additions in 2016 compared to net withdrawals in 2015. This increase was partially offset by less net additions related to pension risk transfer transactions in 2016 as compared to 2015 and a bank-owned life insurance stable value transaction in 2015.

Group Insurance

Operating Results

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

	Year ended December 31, 2017		2016		2015	
	(in millions)					
Operating results:						
Revenues	$ 5,471		$ 5,343		$ 5,143	
Benefits and expenses	5,218		5,123		4,967	
Adjusted operating income	253		220		176	
Realized investment gains (losses), net, and related adjustments	(53	)	(8	)	(1	)
Related charges	0		(6	)	(4	)
Income before income taxes and equity in earnings of operating joint ventures	$ 200		$ 206		$ 171	
Benefits ratio(1):						
Group life(2)	88.9	%	89.1	%	88.7	%
Group disability(2)	71.8	%	75.7	%	75.7	%
Total group insurance(2)	85.8	%	86.7	%	86.6	%
Administrative operating expense ratio(3):						
Group life	11.2	%	10.6	%	11.0	%
Group disability	29.4	%	31.4	%	34.1	%
	14.6	%	14.3	%	15.0	%

Total group insurance

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

(2) Benefits ratios reflect the impacts of our annual reviews and updates of assumptions and other refinements. Excluding these impacts, the group life, group disability and total group insurance benefits ratios were 88.7%, 78.9% and 86.9% for 2017, respectively, 88.5%, 82.9% and 87.5% for 2016, respectively, and 89.2%, 79.2% and 87.5% for 2015, respectively.

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

Adjusted Operating Income

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

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2016 to 2015 Annual Comparison. Adjusted operating income increased $44 million, primarily reflecting favorable comparative net impacts from our annual reviews and update of assumptions and other refinements. Results for 2016 included a $41 million net benefit from these updates, while results for 2015 included a $28 million net benefit. Excluding the effect of these items, adjusted operating income increased $30 million primarily reflecting more favorable underwriting results in our group life business, a higher contribution from net investment spread results, and lower expenses, partially offset by less favorable underwriting results in our group disability business. The underwriting results in our group life business reflected a favorable impact from a reserve refinement and more favorable experience, while the underwriting results in our group disability business reflected the impact of lower claim resolutions on long-term contracts and higher benefits resulting from other claims-related charges, partially offset by the impacts of fewer new claims and increased new business.

Revenues, Benefits and Expenses

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

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

2016 to 2015 Annual Comparison. Revenues increased $200 million. Excluding a favorable comparative impact of $42 million resulting from our annual reviews and update of assumptions and other refinements, revenues increased $158 million. The increase reflected $140 million of higher premiums and policy charges and fee income primarily driven by the increase in new business in both our group life and group disability businesses, as well as higher premiums on existing experience-rated contracts in our group life business. Net investment income increased $21 million driven by higher prepayment income and income from non-coupon investments.

Benefits and expenses increased $156 million. Excluding an unfavorable comparative impact of $29 million resulting from our annual review and update of assumptions and other refinements, benefits and expenses increased $127 million. Policyholders’ benefits, including the change in reserves, increased $120 million, driven by the impact of new business for both our group life and group disability businesses, the impact of lower claim resolutions on long-term contracts in our group disability business, and higher benefits on existing experience-rated contracts in our group life business, partially offset by a decrease in general and administrative expenses.

Sales Results

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

	Year ended December 31,		
	2017	2016	2015
	(in millions)		

Annualized new business premiums(1):			
Group life	$ 287	$ 316	$ 204
Group disability	153	119	69
Total	$ 440	$ 435	$ 273

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(1) Amounts exclude new premiums resulting from rate changes on existing policies, from additional coverage under our Servicemembers’ Group Life Insurance contract and from excess premiums on group universal life insurance that build cash value but do not purchase face amounts.

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

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2016 to 2015 Annual Comparison. Total annualized new business premiums increased $162 million as we continued to grow through sales to new and existing clients in both our group disability business and our group life business, which included a large client sale in 2016, while maintaining pricing and underwriting discipline.

Investment Management Division

Investment Management

Operating Results

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

	Year ended December 31,		
	2017	2016	2015
	(in millions)		
Operating results(1):			
Revenues	$3,355	$2,961	$2,944
Expenses	2,376	2,174	2,165
Adjusted operating income	979	787	779
Realized investment gains (losses), net, and related adjustments	(4)	(6)	(4)
Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests	95	45	50
Income (loss) before income taxes and equity in earnings of operating joint ventures	$1,070	$826	$825

(1) Certain of our Investment Management segment's investment activities are based in currencies other than the U.S. dollar and are therefore subject to foreign currency exchange rate risk. Effective January 1, 2016, the financial results of our Investment Management segment include the impact of an intercompany arrangement with our Corporate and Other operations designed to mitigate the impact of exchange rate changes on the segment's U.S. dollar-equivalent earnings. For more information related to this intercompany arrangement, see "—Results of Operations—Impact of Foreign Currency Exchange Rates," above.

Adjusted Operating Income

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

2016 to 2015 Annual Comparison. Adjusted operating income increased $8 million. The increase primarily reflected higher asset management fees, net of related expenses, driven by an increase in average fixed income assets under management as a result of net inflows, market appreciation, and a favorable fee rate modification within certain real estate funds that occurred in the third quarter of 2016, partially offset by a decline in average equity assets under management as a result of net outflows and market volatility experienced in the first half of 2016. The increase was also partially offset by lower other related revenues, net of associated expenses, primarily related to lower strategic investing results and lower equity fund-related incentive fees, net of expenses.

Revenues and Expenses

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

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	Year ended December 31,		
	2017	2016	2015
	(in millions)		
Revenues by type:			
Asset management fees by source:			
Institutional customers	$ 1,147	$ 1,046	$ 923
Retail customers(1)	800	707	764
General account	470	474	448
Total asset management fees	2,417	2,227	2,135
Other related revenues by source:			
Incentive fees	197	108	88
Transaction fees	27	19	20
Strategic investing	88	25	30
Commercial mortgage(2)	127	103	103
Total other related revenues(3)	439	255	241
Service, distribution and other revenues(4)	499	479	568
Total revenues	$ 3,355	$ 2,961	$ 2,944

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

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

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

(4) Includes payments from Wells Fargo under an agreement dated as of July 30, 2004, implementing arrangements with respect to money market mutual funds in connection with the combination of our retail securities brokerage and clearing operations with those of Wells Fargo. The agreement extends for ten years after termination of the Wachovia Securities joint venture, which occurred on December 31, 2009. The revenue from Wells Fargo under this agreement was $80 million in 2017, $84 million in 2016 and $78 million in 2015.

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

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

2016 to 2015 Annual Comparison. Revenues increased $17 million. Total asset management fees increased $92 million, primarily as a result of net inflows and market appreciation within fixed income as well as from a favorable fee rate modification within certain real estate funds that occurred in the third quarter of 2016. Other related revenues increased $14 million, primarily due to higher performance-based incentive fees related to certain fixed income hedge funds. Partially offsetting these increases was an $89 million decrease in service, distribution and other revenues reflecting lower service and other fees as well as the deconsolidation of certain collateralized loan obligations.

Expenses increased $9 million, as a result of business growth, higher compensation related to favorable fixed income results and higher performance-based incentive fees (included in noncontrolling interest), partially offset by the deconsolidation of certain funds, as discussed above.

Assets Under Management

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

	December 31,		
	2017	2016	2015
	(in billions)		
Assets Under Management (at fair value):			
Institutional customers:			
Equity	$68.0	$59.3	$59.9
Fixed income	379.4	332.2	289.9
Real estate	42.1	40.0	39.3
Institutional customers(1)	489.5	431.5	389.1
Retail customers:			
Equity	132.4	112.4	121.4
Fixed income	111.5	94.5	73.7
Real estate	1.7	2.3	2.2
Retail customers(2)	245.6	209.2	197.3
General account:			
Equity	5.8	6.4	7.4
Fixed income	412.5	391.3	367.5
Real estate	1.9	1.7	1.8
General account	420.2	399.4	376.7
Total assets under management	$1,155.3	$1,040.1	$963.1

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

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

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

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	December 31,		
	2017	2016	2015
	(in billions)		
Institutional Customers:			
Beginning assets under management	$431.5	$389.1	$370.0
Net additions (withdrawals), excluding money market activity:			
Third-party	11.6	5.3	21.2
Third-party via affiliates(1)	2.4	0.8	(4.8)
Total	14.0	6.1	16.4
Market appreciation (depreciation)(2)	42.9	24.2	2.6
Other increases (decreases)(3)	1.1	12.1	0.1
Ending assets under management	$489.5	$431.5	$389.1
Retail Customers:			
Beginning assets under management	$209.2	$197.3	$186.1
Net additions (withdrawals), excluding money market activity:			
Third-party	4.1	0.4	0.8
Third-party via affiliates(1)	(2.0)	(0.5)	9.2
Total	2.1	(0.1)	10.0
Market appreciation (depreciation)(2)	34.6	9.1	1.4
Other increases (decreases)(3)	(0.3)	2.9	(0.2)
Ending assets under management	$245.6	$209.2	$197.3
General Account:			
Beginning assets under management	$399.4	$376.7	$377.4
Net additions (withdrawals), excluding money market activity:			
Third-party	0.0	0.0	0.0
Affiliated	3.9	8.9	(1.1)
Total	3.9	8.9	(1.1)
Market appreciation (depreciation)(2)	15.1	13.3	(1.5)
Other increases (decreases)(3)	1.8	0.5	1.9
Ending assets under management	$420.2	$399.4	$376.7

(1) Represents assets that our Investment Management segment manages for the benefit of other reporting segments within the Company. Additions and withdrawals of these assets are attributable to third-party product inflows and outflows in other reporting segments.
(2) Includes income reinvestment, where applicable.
(3) Includes the effect of foreign exchange rate changes, net money market activity primarily related to cash collateral received or released in conjunction with our Annuities' living benefits hedging program, and the impact of acquired business. The impact from foreign currency fluctuations, which primarily impact the general account, resulted in gains of $4.7 billion, gains of $2.7 billion and losses of $1.7 billion for the years ended December 31, 2017, 2016 and 2015, respectively.

Strategic Investments

The following table sets forth the strategic investments of the Investment Management segment at carrying value (including the value of derivative instruments used to mitigate equity market and currency risk) by asset class and source as of the dates indicated.

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	December 31,	
	2017	2016
	(in millions)	
Co-Investments:		
Real estate	$185	$165
Fixed income	584	218
Seed Investments:		
Real estate	50	46
Public equity	658	441
Fixed income	309	279
Total	$1,786	$1,149

The increase in strategic investments was primarily driven by a higher level of investment in collateralized loan obligations and the funding of new mutual funds.

International Insurance Division

International Insurance

Operating Results

The results of our International Insurance operations are translated on the basis of weighted average monthly exchange rates, inclusive of the effects of the intercompany arrangement discussed in "—Results of Operations—Impact of Foreign Currency Exchange Rates" above. To provide a better understanding of operating performance within the International Insurance segment, where indicated below, we have analyzed our results of operations excluding the effect of the year over year change in foreign currency exchange rates. Our results of operations, excluding the effect of foreign currency fluctuations, were derived by translating foreign currencies to U.S. dollars at uniform exchange rates for all periods presented, including for constant dollar information discussed below. The exchange rates used were Japanese yen at a rate of 112 yen per U.S. dollar and Korean won at a rate of 1130 won per U.S. dollar, both of which were determined in connection with the foreign currency income hedging program discussed in "—Results of Operations—Impact of Foreign Currency Exchange Rates" above. In addition, for constant dollar information discussed below, activity denominated in U.S. dollars is generally reported based on the amounts as transacted in U.S. dollars. Annualized new business premiums presented on a constant exchange rate basis in the "Sales Results" section below reflect translation based on these same uniform exchange rates.

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

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	Year ended December 31,		
	2017	2016	2015
	(in millions)		
Operating results:			
Revenues:			
Life Planner operations	$10,644	$9,986	$9,172
Gibraltar Life and Other operations	10,916	11,023	10,192
Total revenues	21,560	21,009	19,364
Benefits and expenses:			
Life Planner operations	9,151	8,447	7,587
Gibraltar Life and Other operations	9,211	9,445	8,551
Total benefits and expenses	18,362	17,892	16,138
Adjusted operating income:			
Life Planner operations	1,493	1,539	1,585
Gibraltar Life and Other operations	1,705	1,578	1,641
Total adjusted operating income	3,198	3,117	3,226
Realized investment gains (losses), net, and related adjustments	985	992	1,215
Related charges	(18)	(32)	(60)
Investment gains (losses) on trading account assets supporting insurance liabilities, net	218	4	57
Change in experience-rated contractholder liabilities due to asset value changes	(218)	(4)	(57)
Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests	(43)	(47)	8
Income (loss) before income taxes and equity in earnings of operating joint ventures	$4,122	$4,030	$4,389

Adjusted Operating Income

2017 to 2016 Annual Comparison. Adjusted operating income from our Life Planner operations decreased $46 million including a net unfavorable impact of $32 million from currency fluctuations, inclusive of the currency hedging program discussed above. Both periods also include the impact of our annual reviews and update of assumptions and other refinements, which resulted in a $67 million net charge in 2017, including impacts from unfavorable economic assumption updates driven by a lower long-term interest rate assumption in Japan, compared to a $38 million net charge in 2016.

Excluding the effect of these items, adjusted operating income increased $15 million, primarily reflecting the growth of business in force in our Japan and Brazil operations, improved policyholder experience, and a higher contribution from net investment results, primarily from higher income on non-coupon investments and higher net prepayment fee income, partially offset by lower reinvestment rates. These favorable impacts were partially offset by higher expenses, including legal costs and expenses supporting business growth.

Adjusted operating income from our Gibraltar Life and Other operations increased $127 million including a net unfavorable impact of $8 million from currency fluctuations, inclusive of the currency hedging program discussed above. Both periods also include the impact of our annual reviews and update of assumptions and other refinements, which resulted in a $21 million net benefit in 2017 compared to a $34 million net charge in 2016.

Excluding the effect of these items, adjusted operating income increased $80 million, primarily reflecting the growth of business in force, including higher earnings from our indirect investment in AFP Habitat which reflected twelve months of income in the current year compared to ten months of income in the prior year, improved policyholder experience and more favorable comparative mortality experience. These favorable impacts were partially offset by the absence of a gain on the sale of a home office property in Japan in the prior year.

2016 to 2015 Annual Comparison. Adjusted operating income from our Life Planner operations decreased $46 million including a net unfavorable impact of $97 million from currency fluctuations, inclusive of the currency hedging program discussed above. Both periods included the impact of our annual reviews and updates of assumptions and other refinements, which resulted in a $38 million net charge in 2016, including unfavorable economic assumption updates driven by lower interest rates in Japan and Korea, compared to an $11 million net charge in 2015.

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Excluding the effect of these items, adjusted operating income increased $78 million, primarily reflecting the growth of business in force and continued strong persistency in Japan, and a larger contribution from non-coupon investments. These favorable impacts were partially offset by higher expenses, including those supporting business growth, and less favorable comparative mortality experience.

Adjusted operating income from our Gibraltar Life and Other operations decreased $63 million including a net unfavorable impact of $169 million from currency fluctuations, inclusive of the currency hedging program discussed above. Both periods included the impact of our annual reviews and updates of assumptions and other refinements which resulted in a $34 million net charge in 2016, including unfavorable economic assumption updates driven by lower interest rates in Japan, compared to a $10 million net charge in 2015.

Excluding the effect of these items, adjusted operating income increased $130 million as the growth of business in force, including the contribution from the Company's investment in AFP Habitat in Chile in March of 2016, more favorable comparative mortality experience and lower net expenses, including a gain on the sale of a home office property in Japan, were partially offset by a lower contribution from net investment spreads, primarily from lower income on non-coupon investments.

Revenues, Benefits and Expenses

2017 to 2016 Annual Comparison. Revenues from our Life Planner operations increased $658 million including a net unfavorable impact of $55 million from currency fluctuations and a net benefit of $15 million from our annual reviews and update of assumptions and other refinements. Excluding these items, revenues increased $698 million. This increase was primarily driven by higher premiums and policy charges and fee income of $518 million related to growth of business in force, as discussed above. Net investment income increased $167 million primarily reflecting higher income on non-coupon investments and higher net prepayment fee income, partially offset by lower reinvestment rates.

Benefits and expenses from our Life Planner operations increased $704 million including a net favorable impact of $23 million from currency fluctuations and a net charge of $44 million from our annual reviews and update of assumptions and other refinements. Excluding these items, benefits and expenses increased $683 million. Policyholder benefits, including changes in reserves, increased $427 million primarily driven by business growth. General and administrative expenses, net of capitalization, increased $201 million primarily due to higher operating expenses, including legal costs and expenses supporting business growth.

Revenues from our Gibraltar Life and Other operations decreased $107 million, including a net unfavorable impact of $166 million from currency fluctuations and a net benefit of $13 million from our annual reviews and update of assumptions and other refinements. Excluding these items, revenues increased $46 million. This increase was primarily driven by higher premiums and policy charges and fee income related to the growth of business in force, as discussed above, and higher net investment income.

Benefits and expenses from our Gibraltar Life and Other operations decreased $234 million including a net favorable impact of $158 million from currency fluctuations and a net benefit of $42 million from our annual reviews and update of assumptions and other refinements. Excluding these items, benefits and expenses decreased $34 million, driven by a decrease in policyholder benefits, including changes in reserves, related to improved policyholder experience and more favorable comparative mortality experience, as discussed above.

2016 to 2015 Annual Comparison. Revenues from our Life Planner operations increased $814 million including a net favorable impact of $287 million from currency fluctuations. Excluding the impact of currency fluctuations, revenues increased $527 million. This increase was primarily driven by higher premiums and policy charges and fee income of

$372 million related to growth of business in force. Net investment income increased $152 million primarily reflecting investment portfolio growth related to the growth of business in force, partially offset by the impact of lower reinvestment rates.

Benefits and expenses from our Life Planner operations increased $860 million including a net unfavorable impact of $384 million from currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased $476 million. Policyholder benefits, including changes in reserves, increased $370 million primarily driven by business growth. General and administrative expenses, net of capitalization, increased $76 million primarily due to higher costs, including those supporting business growth.

Revenues from our Gibraltar Life and Other operations increased $831 million, including a net favorable impact of $321 million from currency fluctuations. Excluding the impact of currency fluctuations, revenues increased $510 million, driven by a $228 million increase in premiums and policy charges and fee income due to business growth, and an $118 million increase in net investment income primarily reflecting investment portfolio growth related to the growth of business in force, partially offset by lower investment spread income, and the gain on the sale of a home office property in Japan.

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Benefits and expenses from our Gibraltar Life and Other operations increased $894 million including a net unfavorable impact of $490 million from currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased $404 million, primarily reflecting a $371 million increase in policyholder benefits, including changes in reserves, related to business growth and $10 million in general and administrative expenses, net of capitalization, due to higher costs, including those supporting business growth.

Sales Results

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

	Year ended December 31,		
	2017	2016	2015
	(in millions)		
Annualized new business premiums:			
On an actual exchange rate basis:			
Life Planner operations(1)	$1,391	$1,276	$1,117
Gibraltar Life	1,598	1,726	1,548
Total	$2,989	$3,002	$2,665
On a constant exchange rate basis:			
Life Planner operations	$1,374	$1,263	$1,147
Gibraltar Life	1,601	1,706	1,595
Total	$2,975	$2,969	$2,742

(1) The amount for the year ended December 31, 2016 has been revised to correct the previously reported amount.

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

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

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

	Year Ended December 31, 2017					Year Ended December 31, 2016				
	Life	Accident &	Retirement (1)	Annuity	Total	Life	Accident &	Retirement (1)	Annuity	Total

		Health					Health			
	(in millions)									
Life Planner	$814	$ 122	$ 352	$ 86	$1,374	$742	$ 114	$ 332	$ 75	$1,263
Gibraltar Life:										
Life Consultants	367	50	113	211	741	352	52	117	212	733
Banks(2)	520	0	33	61	614	518	0	68	130	716
Independent Agency	138	19	66	23	246	128	23	71	35	257
Subtotal	1,025	69	212	295	1,601	998	75	256	377	1,706
Total	$1,839	$ 191	$ 564	$ 381	$2,975	$1,740	$ 189	$ 588	$ 452	$2,969

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

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(2) Single pay life annualized new business premiums, which include 10% of first year premiums, and 3-year limited pay annualized new business premiums, which include 100% of new business premiums, represented 5% and 64%, respectively, of total Japanese bank distribution channel annualized new business premiums, excluding annuity products, for the year ended December 31, 2017, and 9% and 53%, respectively, of total Japanese bank distribution channel annualized new business premiums, excluding annuity products, for the year ended December 31, 2016.

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

Annualized new business premiums, on a constant exchange rate basis, from our Gibraltar Life operations decreased $105 million. Life Consultant sales increased $8 million primarily from higher sales of U.S. dollar-denominated whole life products resulting from the introduction of a new recurring pay life product in the second quarter of 2017. This increase was partially offset by lower sales of yen-denominated whole life and term life products. Bank channel sales decreased $102 million primarily from lower sales of yen-denominated term life and whole life products following the premium rate increases on yen-based products in April of 2017, the suspension of sales of yen-denominated annuity products in April 2016 in response to the low interest rate environment and lower sales of U.S. dollar- and Australian dollar-denominated annuity products due to increased competition and product actions. This decrease was partially offset by higher sales of U.S. dollar-denominated whole life products. Independent Agency sales decreased $11 million primarily reflecting lower sales of yen-denominated whole life and term life products after the April 2017 repricing and lower sales of Australian dollar-denominated annuity products. The decrease was partially offset by higher sales of U.S. dollar-denominated whole life products.

2016 to 2015 Annual Comparison. The table below presents annualized new business premiums on a constant exchange rate basis, by product and distribution channel, for the periods indicated.

	Year Ended December 31, 2016					Year Ended December 31, 2015				
	Life	Accident & Health	Retirement (1)	Annuity	Total	Life	Accident & Health	Retirement (1)	Annuity	Total
	(in millions)									
Life Planner	742	114	332	75	1,263	708	114	264	61	1,147
Gibraltar Life:										
Life Consultants	352	52	117	212	733	331	58	126	140	655
Banks(2)	518	0	68	130	716	472	1	40	180	693
Independent Agency	128	23	71	35	257	98	22	69	58	247
Subtotal	998	75	256	377	1,706	901	81	235	378	1,595
Total	1,740	189	588	452	2,969	1,609	195	499	439	2,742

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

(2) Single pay life annualized new business premiums, which include 10% of first year premiums, and 3-year limited pay annualized new business premiums, which include 100% of new business premiums, represented 9% and 53%, respectively, of total Japanese bank distribution channel annualized new business premiums, excluding annuity products, for the year ended December 31, 2016, and 5% and 51%, respectively, of total Japanese bank distribution channel annualized new business premiums, excluding annuity products, for the year ended December 31, 2015.

Annualized new business premiums, on a constant exchange rate basis, from our Life Planner operations increased $116 million. Growth in Life Planner headcount and productivity in our Japan operation, coupled with the factors described above, resulted in an increase in sales of U.S. dollar-denominated retirement and whole life products while sales of yen-denominated term life products remained strong in the corporate market. Lower sales of life protection products in our Korean operation reflecting pricing actions were partially offset by higher sales in our Brazilian operation across various product lines as Life Planner count and average premiums continued to grow.

Annualized new business premiums, on a constant exchange rate basis, from our Gibraltar Life operations increased $111 million. Life Consultant sales increased $78 million as higher sales of U.S. dollar-denominated annuity and whole life products were partially offset by lower sales of yen-denominated life protection products and Australian dollar-denominated annuity and retirement income products. Bank channel sales increased $23 million primarily driven by higher sales of U.S. dollar-denominated whole life, retirement income and annuity products, partially offset by lower sales of yen-denominated whole life and annuity products and Australian dollar-denominated annuity products. Independent Agency sales increased $10 million as higher sales of U.S. dollar-denominated whole life and retirement income products were partially offset by lower sales of Australian dollar-denominated annuity products and yen-denominated retirement and annuity products.

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Sales Force

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

	As of December 31,		
	2017	2016	2015
Life Planners:			
Japan	3,941	3,824	3,528
All other countries	3,890	3,856	4,064
Gibraltar Life Consultants	8,326	8,884	8,805
Total	16,157	16,564	16,397

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

The number of Gibraltar Life Consultants decreased by 558, primarily reflecting more selective recruiting efforts and retention standards.

2016 to 2015 Comparison. The number of Life Planners increased by 88, driven by an increase of 296 in Japan as a result of improved recruiting efforts and fewer terminations. Life Planners decreased by 208 in other operations, primarily in Korea, Poland and Italy, as a result of more selective recruiting efforts and restructurings, partially offset by an increase in Brazil as a result of recruiting efforts.

The number of Gibraltar Life Consultants increased by 79, primarily reflecting fewer terminations.

Corporate and Other

Our Corporate and Other operations include corporate items and initiatives that are not allocated to business segments and businesses that have been or will be divested.

	Year ended December 31,		
	2017	2016	2015
	(in millions)		
Operating results:			
Capital debt interest expense	$(705)	$(686)	$(731)
Investment income, net of operating debt interest expense	96	1	69
Pension and employee benefits	157	103	173
Other corporate activities(1)	(985)	(999)	(824)
Adjusted operating income	(1,437)	(1,581)	(1,313)
Realized investment gains (losses), net, and related adjustments	(407)	(1,797)	(961)
Related charges	(26)	(1)	19
Divested businesses	38	(84)	(66)
Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests	(19)	(3)	0
Income (loss) before income taxes and equity in earnings of operating joint ventures	$(1,851)	$(3,466)	$(2,321)

(1) Includes consolidating adjustments.

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

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

For purposes of calculating pension income from our qualified pension plan for the year ended December 31, 2018, we will decrease the discount rate from 4.15% to 3.65% as of December 31, 2017. The expected rate of return on plan assets and the assumed rate of increase in compensation will remain unchanged at 6.25% and 4.50%, respectively. Giving effect to the foregoing assumptions and other factors, we expect income from our qualified pension plan in 2018 to be approximately $45 million to $50 million higher than 2017 levels. The increase is driven by higher expected returns on plan assets due to higher than expected plan fixed income asset growth in 2017 as well as lower interest costs on the plan obligation due to the lower discount rate.

For purposes of calculating postretirement benefit expenses for the year ended December 31, 2018, we will decrease the discount rate from 4.05% to 3.60% as of December 31, 2017. The expected rate of return on plan assets will remain unchanged at 7.00%. Giving effect to the foregoing assumptions and other factors, we expect postretirement benefit expenses in 2018 to be approximately $30 million to $40 million lower than 2017 levels. The decrease in expenses is driven by favorable census updates at December 31, 2017, and higher expected returns on plan assets due to higher than expected asset growth in 2017.

In 2018, pension and other postretirement benefit service costs related to active employees will continue to be allocated to our business segments. For further information regarding our pension and postretirement plans, see Note 18 to the Consolidated Financial Statements.

2016 to 2015 Annual Comparison. The loss from Corporate and Other operations, on an adjusted operating income basis, increased $268 million. Net charges from other corporate activities increased $175 million, primarily reflecting higher costs for employee compensation plans tied to Company stock and equity market returns, increased costs for enhanced regulatory supervision, costs associated with the early extinguishment of certain debt, higher legal costs, the absence of a favorable impact from escheatment related matters in the prior year and increased costs related to other corporate initiatives. The increased charges were partially offset by the absence of certain remediation costs incurred in the prior year. Results for investment income, net of operating debt interest expense, decreased $68 million, primarily reflecting lower levels of invested assets resulting from assets transferred to other business segments and lower net investment income from non-coupon investments. This decrease was partially offset by lower operating debt interest expense resulting from efforts to reduce leverage through senior debt maturities in late 2015 and early 2016, and the early extinguishment of certain debt in the second quarter of 2016. Capital debt interest expense decreased $45 million, primarily reflecting the reassignment of capital debt to operating debt and efforts to reduce leverage.

Income from pension and employee benefits decreased $70 million, primarily reflecting lower income from our qualified pension plan, driven by lower expected returns on plan assets due to lower than expected plan fixed income asset growth in 2015, as well as higher interest costs on the plan obligation due to a higher discount rate.

Capital Protection Framework

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"Realized investment gains (losses), net and related adjustments," which are excluded from adjusted operating income, included net losses of $154 million, $1,649 million and $673 million for the years ended December 31, 2017, 2016 and 2015, respectively, related to our Capital Protection Framework. The comparative variance between 2017 and the prior years is primarily attributed to changes in our Individual Annuities risk management strategy implemented in 2016, whereby we terminated the existing intercompany derivative transactions between Corporate and Other operations and the Individual Annuities business segment related to managing interest rate risk and we now manage this risk within the Individual Annuities business segment. The net losses in 2016 and 2015, while the intercompany derivative transactions between Corporate and Other operations and the Individual Annuities business segment were in place, primarily resulted from our utilization of capital management strategies to manage a portion of our interest rate risk, and reflect changes in interest rates with respect to the exposures outstanding during the respective periods. For more information on our Individual Annuities risk management strategy, see "—Individual Annuities." For more information on our Capital Protection Framework, see "—Liquidity and Capital Resources—Capital Protection Framework."

Divested Businesses

Divested Businesses Included in Corporate and Other

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

	Year ended December 31, 2017	2016	2015
	(in millions)		
Long-Term Care	$ 42	$ (74)	$ (67)
Other	(4)	(10)	1
Total divested businesses income (loss) excluded from adjusted operating income	$ 38	$ (84)	$ (66)

Long-Term Care. Results for the year ended December 31, 2017 increased compared to 2016 primarily reflecting net realized investment gains in 2017 compared to net realized investment losses in 2016, driven by a favorable comparative change in the market value of derivatives used in duration management, and higher net investment income. These increases were partially offset by unfavorable policy experience. Results for the year ended December 31, 2016 decreased compared to 2015 primarily reflecting an increase in net realized investment losses, driven by the unfavorable comparative change in the market value of derivatives used in duration management. This decrease was partially offset by favorable policy experience and higher net investment income.

Closed Block Division

The Closed Block division includes certain in force traditional domestic participating life insurance and annuity products and assets that are used for the payment of benefits and policyholder dividends on these policies (collectively, the “Closed Block”), as well as certain related assets and liabilities. We no longer offer these traditional domestic participating policies. See Note 12 to the Consolidated Financial Statements for additional details.

Each year, the Board of Directors of Prudential Insurance determines the dividends payable on participating policies for the following year based on the experience of the Closed Block, including investment income, net realized and unrealized investment gains, mortality experience and other factors. Although Closed Block experience for dividend action decisions is based upon statutory results, at the time the Closed Block was established, we developed, as required by U.S. GAAP, an actuarial calculation of the timing of the maximum future earnings from the policies included in the Closed Block. If actual cumulative earnings in any given period are greater than the cumulative earnings we expected, we record this excess as a policyholder dividend obligation. We will subsequently pay this excess to Closed Block policyholders as an additional dividend unless it is otherwise offset by future Closed Block performance that is less favorable than we originally expected. The policyholder dividends we charge to expense within the Closed Block division will include any change in our policyholder dividend obligation that we recognize for the excess of actual cumulative earnings in any given period over the cumulative earnings we expected in addition to the actual policyholder dividends declared by the Board of Directors of Prudential Insurance.

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As of December 31, 2017, the excess of actual cumulative earnings over the expected cumulative earnings was $1,790 million, which was recorded as a policyholder dividend obligation. Actual cumulative earnings, as required by U.S. GAAP, reflect the recognition of realized investment gains and losses in the current period, as well as changes in assets and related liabilities that support the Closed Block policies. Additionally, the accumulation of net unrealized investment gains that have arisen subsequent to the establishment of the Closed Block have been reflected as a policyholder dividend obligation of $3,656 million at December 31, 2017, to be paid to Closed Block policyholders unless offset by future experience, with a corresponding amount reported in AOCI.

Operating Results

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

	Year ended December 31,		
	2017	2016	2015
	(in millions)		
U.S. GAAP results:			
Revenues	$5,826	$5,669	$6,160
Benefits and expenses	5,781	5,801	6,102
Income (loss) before income taxes and equity in earnings of operating joint ventures	$45	$(132)	$58

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

2017 to 2016 Annual Comparison. Income (loss) before income taxes and equity in earnings of operating joint ventures increased $177 million. Results for 2017 primarily reflected a $175 million increase in net realized investment gains and related activity, primarily due to higher gains from sales of equity securities and fixed maturities, partially offset by unfavorable changes in the value of derivatives used in risk management activities. Net insurance activity results increased $92 million, primarily as a result of a decrease in the 2018 dividend scale, partially offset by the runoff of policies in force and higher benefit payments. Net investment income increased $75 million, primarily driven by higher income on non-coupon investments and higher prepayment income, partially offset by lower reinvestment rates. As a result of the above and other variances, a $143 million increase in the policyholder dividend obligation was recorded in 2017, compared to $48 million reduction in 2016. If actual cumulative earnings fall below expected cumulative earnings in future periods, earnings volatility in the Closed Block division, which is primarily due to changes in investment results, may not be offset by changes in the cumulative earnings policyholder dividend obligation. For a discussion of Closed Block division realized investment gains (losses), net, see "—Realized Investment Gains and Losses."

2016 to 2015 Annual Comparison. Income (loss) before income taxes and equity in earnings of operating joint ventures decreased $190 million. Results for 2016 primarily reflected a $399 million decrease in net realized investment gains, primarily due to lower gains on equity securities, lower gains from sales of fixed maturities and less favorable changes in the value of derivatives used in risk management activities. Net investment income decreased $75 million, primarily due to lower returns on non-coupon investments and lower reinvestment rates, partially offset by higher prepayment fee income. Net insurance activity results increased $35 million, primarily due to lower benefit payments. As a result of the above and other variances, a $48 million reduction in the policyholder dividend obligation was recorded in 2016, compared to a $137 million increase in 2015.

Revenues, Benefits and Expenses

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

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

2016 to 2015 Annual Comparison. Revenues decreased $491 million, primarily due to a $399 million decrease in net realized investment gains and a $75 million decrease in net investment income, as discussed above.

Benefits and expenses decreased $301 million, primarily due to a $189 million decrease in dividends to policyholders, reflecting a decrease in the policyholder dividend obligation expense due to changes in cumulative earnings. In addition, policyholders' benefits, including changes in reserves, decreased $83 million, primarily due to the runoff of policies in force.

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Income Taxes

The differences between income taxes expected at the U.S. federal statutory income tax rate of 35% and the reported income tax (benefit) expense are provided in the following table:

	Year Ended December 31,		
	2017	2016	2015
	(in millions)		
Expected federal income tax expense (benefit) at federal statutory rate	$2,270	$1,997	$2,719
Non-taxable investment income	(369)	(352)	(341)
Foreign taxes at other than U.S. rate	(249)	(172)	(51)
Low-income housing and other tax credits	(126)	(118)	(116)
Changes in tax law	(2,858)	0	(108)
Other	(106)	(20)	(31)
Reported income tax expense (benefit)	$(1,438)	$1,335	$2,072
Effective tax rate	(22.2)%	23.4%	26.7%

Effective Tax Rate

The effective tax rate is the ratio of “Total income tax expense (benefit)” divided by “Income before income taxes and equity in earnings of operating joint ventures.” Our effective tax rate for fiscal years 2017, 2016 and 2015 was (22.2)%, 23.4% and 26.7%, respectively. For a detailed description of the nature of each significant reconciling item, see Note 19 to the Consolidated Financial Statements. The decrease in the effective tax rate from 26.7% in 2015 to 23.4% in 2016 was primarily driven by a decrease in pre-tax net income. The decrease in the effective tax rate from 23.4% in 2016 to (22.2)% in 2017 was primarily driven by the impacts of the Tax Act of 2017 on the date of enactment. Going forward, we generally expect a lower future effective tax rate than we have reported in recent years. This reduction is primarily due to applying the lower corporate tax rate under the Tax Act of 2017 to our U.S. businesses’ earnings.

Unrecognized Tax Benefits

The Company’s liability for income taxes includes the liability for unrecognized tax benefits and interest that relate to tax years still subject to review by the IRS or other taxing authorities. The completion of review or the expiration of the Federal statute of limitations for a given audit period could result in an adjustment to the liability for income taxes. The total unrecognized benefit as of December 31, 2017, 2016 and 2015 was $45 million, $26 million and $6 million, respectively. We do not anticipate any significant changes within the next twelve months to our total unrecognized tax benefits related to tax years for which the statute of limitations has not expired.

Income Tax Expense vs. Income Tax Paid in Cash

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

For additional information on income tax related items, see “Business—Regulation” and Note 19 to the Consolidated Financial Statements.

Experience-Rated Contractholder Liabilities, Trading Account Assets Supporting Insurance Liabilities and Other Related Investments

Certain products included in the Retirement and International Insurance segments are experience-rated in that investment results associated with these products are expected to ultimately accrue to contractholders. The majority of investments supporting these experience-rated products are classified as trading and are carried at fair value. These trading investments are reflected on the Consolidated Statements of Financial Position as “Trading account assets supporting insurance liabilities, at fair value” (“TAASIL”). Realized and unrealized gains (losses) for these investments are reported in “Other income.” Interest and dividend income for these investments is reported in “Net investment income.” To a lesser extent, these experience-rated products

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are also supported by derivatives and commercial mortgage and other loans. The derivatives that support these experience-rated products are reflected on the Consolidated Statements of Financial Position as “Other long-term investments” and are carried at fair value, and the realized and unrealized gains (losses) are reported in “Realized investment gains (losses), net.” The commercial mortgage and other loans that support these experience-rated products are carried at unpaid principal, net of unamortized discounts and an allowance for losses, and are reflected on the Consolidated Statements of Financial Position as “Commercial mortgage and other loans.” Gains (losses) on sales and changes in the valuation allowance for commercial mortgage and other loans are reported in “Realized investment gains (losses), net.”

Our Retirement segment has two types of experience-rated products that are supported by TAASIL and other related investments. Fully participating products are those for which the entire return on underlying investments is passed back to the policyholders through a corresponding adjustment to the related liability, primarily classified in the Consolidated Statements of Financial Position as “Policyholders’ account balances.” The adjustment to the liability is based on changes in the fair value of all of the related assets, including commercial mortgage and other loans, which are carried at amortized cost, less any valuation allowance. Partially participating products are those for which only a portion of the return on underlying investments is passed back to the policyholders over time through changes to the contractual crediting rates. The crediting rates are typically reset semiannually, often subject to a minimum crediting rate, and returns are required to be passed back within ten years.

In our International Insurance segment, the experience-rated products are fully participating. As a result, the entire return on the underlying investments is passed back to policyholders through a corresponding adjustment to the related liability.

Adjusted operating income excludes net investment gains (losses) on TAASIL, related derivatives and commercial mortgage and other loans. This is consistent with the exclusion of realized investment gains (losses) with respect to other investments supporting insurance liabilities managed on a consistent basis. In addition, to be consistent with the historical treatment of charges related to realized investment gains (losses) on investments, adjusted operating income also excludes the change in contractholder liabilities due to asset value changes in the pool of investments (including changes in the fair value of commercial mortgage and other loans) supporting these experience-rated contracts, which are reflected in “Interest credited to policyholders’ account balances.” The result of this approach is that adjusted operating income for these products includes net fee revenue and interest spread we earn on these experience-rated contracts, and excludes changes in fair value of the pool of investments, both realized and unrealized, that we expect will ultimately accrue to the contractholders.

The following table sets forth the impact on results for the periods indicated of these items that are excluded from adjusted operating income:

	Year ended December 31,		
	2017	2016	2015
	(in millions)		
Retirement Segment:			
Investment gains (losses) on:			
Trading account assets supporting insurance liabilities, net	$118	$(21)	$(581)
Derivatives	(168)	(10)	138
Commercial mortgages and other loans	(7)	5	4
Change in experience-rated contractholder liabilities due to asset value changes(1)(2)	67	25	490
Net gains (losses)	$10	$(1)	$51

International Insurance Segment:			
Investment gains (losses) on trading account assets supporting insurance liabilities, net	$218	$4	$57
Change in experience-rated contractholder liabilities due to asset value changes	(218)	(4)	(57)
Net gains (losses)	$0	$0	$0
Total:			
Investment gains (losses) on:			
Trading account assets supporting insurance liabilities, net	$336	$(17)	$(524)
Derivatives	(168)	(10)	138
Commercial mortgages and other loans	(7)	5	4
Change in experience-rated contractholder liabilities due to asset value changes(1)(2)	(151)	21	433
Net gains (losses)	$10	$(1)	$51

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(1) Decreases to contractholder liabilities due to asset value changes are limited by certain floors and therefore do not reflect cumulative declines in recorded asset values of $18 million, $10 million and $15 million as of December 31, 2017, 2016 and 2015, respectively. We have recovered and expect to recover in future periods these declines in recorded asset values through subsequent increases in recorded asset values or reductions in crediting rates on contractholder liabilities.

(2) Included in the amounts above related to the change in the liability to contractholders as a result of commercial mortgage and other loans are a decrease of $21 million, an increase of $4 million and a decrease of $64 million for the years ended December 31, 2017, 2016 and 2015, respectively. As prescribed by U.S. GAAP, changes in the fair value of commercial mortgage and other loans held for investment in our general account, other than when associated with impairments, are not recognized in income in the current period, while the impact of these changes in fair value are reflected as a change in the liability to fully participating contractholders in the current period.

The net impacts for the Retirement segment of changes in experience-rated contractholder liabilities and investment gains (losses) on trading account assets supporting insurance liabilities and other related investments reflect timing differences between the recognition of the mark-to-market adjustments and the recognition of the recovery of these adjustments in future periods through subsequent increases in asset values or reductions in crediting rates on contractholder liabilities for partially participating products. These impacts also reflect the difference between the fair value of the underlying commercial mortgage and other loans and the amortized cost, less any valuation allowance, of these loans, as described above.

Valuation of Assets and Liabilities

Fair Value of Assets and Liabilities

The authoritative guidance related to fair value measurement establishes a framework that includes a three-level hierarchy used to classify the inputs used in measuring fair value. The level in the hierarchy within which the fair value falls is determined based on the lowest level input that is significant to the measurement. The fair values of assets and liabilities classified as Level 3 include at least one significant unobservable input in the measurement. See Note 20 to the Consolidated Financial Statements for an additional description of the valuation hierarchy levels as well as for the balances of assets and liabilities measured at fair value on a recurring basis by hierarchy level presented on a consolidated basis.

The table below presents the balances of assets and liabilities measured at fair value on a recurring basis, as of the periods indicated, and the portion of such assets and liabilities that are classified in Level 3 of the valuation hierarchy. The table also provides details about these assets and liabilities excluding those held in the Closed Block division. We believe the amounts excluding the Closed Block division are most relevant to an understanding of our operations that are pertinent to investors in Prudential Financial because substantially all Closed Block division assets support obligations and liabilities relating to the Closed Block policies only. See Note 12 to the Consolidated Financial Statements for further information on the Closed Block.

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	As of December 31, 2017				As of December 31, 2016			
	PFI excluding Closed Block Division		Closed Block Division		PFI excluding Closed Block Division		Closed Block Division	
	Total at Fair Value	Total Level 3(1)	Total at Fair Value	Total Level 3(1)	Total at Fair Value	Total Level 3(1)	Total at Fair Value	Total Level 3(1)
	(in millions)							
Fixed maturities, available-for-sale	$305,518	$ 7,557	$41,262	$ 2,139	$282,515	$ 5,501	$38,904	$ 1,356
Trading account assets:								
Fixed maturities	23,516	1,563	200	1	23,143	747	160	0
Equity securities	2,659	443	139	66	2,267	429	124	58
All other(2)	1,226	8	0	0	1,760	1	0	0
Subtotal	27,401	2,014	339	67	27,170	1,177	284	58
Equity securities, available-for-sale	3,834	273	2,340	17	7,176	253	2,572	12
Commercial mortgage and other loans	593	0	0	0	519	0	0	0
Other long-term investments(3)	270	136	2	0	146	7	3	0
Short-term investments	5,328	8	436	0	6,383	1		