U.S. SECURITIES AND EXCHANGE COMMISSION

Litigation Release No. 20670 / August 6, 2008

Securities and Exchange Commission v. Prudential Financial, Inc., 08 Civ. 3916 (PGS) (D.N.J.)

Accounting and Auditing Enforcement Release No. 2860 / August 6, 2008

Prudential Financial, Inc. Settles Financial Reporting and Related Charges by SEC for Improperly Reporting Over $200 Million in Income as a Result of Purported Reinsurance Contracts

On August 6, 2008, the Securities and Exchange Commission filed a civil injunctive action in United States District Court for the District of New Jersey charging Prudential Financial, Inc., a leading provider of financial services, with violating the financial reporting, books-and-records, and internal control provisions of the Securities Exchange Act of 1934. Prudential has agreed to settle the case, without admitting or denying the Commission's allegations, by consenting to the entry of a permanent injunction.

The Commission's complaint, filed in federal court in Newark, alleges that from December 1997 through December 2002, Prudential's former property and casualty subsidiaries known as the Prupac companies ("Prupac"), entered into a series of so-called finite reinsurance contracts with General Reinsurance Corporation ("Gen Re") that had no economic substance and no purpose other than to build up and then draw down on an off-balance sheet asset, or "bank," that Gen Re held for Prupac. According to the complaint, the contracts were shams, written to look like they met the requirements to qualify for reinsurance accounting; in fact, they were subject to an oral side agreement that effectively eliminated any risk to either party and made such accounting improper. Prupac built up the bank in 1997, 1998 and 1999 and then, in 2000, 2001 and 2002, drew down on the bank and improperly recorded the repayments as income. In 2001, Prudential became a public company and the inaccurate financial statements became a part of its annual, quarterly and current filings thereafter.

The complaint alleges that the improper accounting practices began in 1997, when Prudential and Gen Re negotiated a riskless reinsurance contract under which Prupac paid Gen Re $50 million. The contract was entered into in the final days of the coverage period, but backdated to appear as if it had been agreed to before the coverage period began. The understanding between the

parties was that Gen Re would credit Prupac with interest at the one-year Treasury bill rate and also collect a fee on the money it held. It was further agreed that the relationship would be riskless: If Gen Re lost money in the early years of the relationship, when its exposure on the purported reinsurance contracts was greater than the amount in the bank, Prupac would make Gen Re whole. The parties kept track of where they stood in the relationship by means of a ledger, called an "Experience Account Balance," which showed payments made into the bank, less fees, plus interest, and less payments out.

From 1997 through 2000, Prupac built up the bank, depositing approximately $190 million of the $200 million it would eventually deposit with Gen Re in the form of premiums on reinsurance policies for which no reinsurance recoveries were triggered. In 2000, 2001, and 2002, Prupac drew down on the bank, structuring the purported reinsurance contracts to ensure it recovered virtually to the penny every payment it had made, plus interest, less Gen Re's fee. As a result of these recoveries, Prudential improperly reported additional pre-tax income of $97 million, $80 million and $41 million in 2000, 2001 and 2002, respectively.

The complaint alleges that the improper accounting practices within Prudential's Property and Casualty Insurance division resulted in an overstatement of Prudential's consolidated pre-tax income for 2000, 2001 and 2002 by $57 million or 9%, $75 million or 25%, and by $38 million or 146%, respectively. As a result of these improper accounting practices, Prudential filed annual, quarterly and current reports with the Commission that included financial statements that were inaccurate and misleading and violated the financial reporting, books-and-records, and internal controls provisions of the Exchange Act. Specifically, the complaint alleges that Prudential violated Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder.

Without admitting or denying the Commission's allegations, Prudential has agreed to settle the charges by consenting to a permanent injunction against further violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder.

➤ SEC Complaint in this matter

http://www.sec.gov/litigation/litreleases/2008/lr20670.htm
