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UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

SECURITIES AND EXCHANGE COMMISSION,	:	
Plaintiff,	:	**08 Civ.** 3916 (PGS)
v.	:	
PRUDENTIAL FINANCIAL, INC.	:	**<u>COMPLAINT</u>**
Defendant.	:	

Plaintiff Securities and Exchange Commission, for its complaint against defendant Prudential Financial, Inc., alleges as follows:

PRELIMINARY STATEMENT

1. This action arises out of Prudential's improper reporting of over $200 million in income as a result of a round-trip arrangement effected through a series of purported reinsurance contracts. 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. 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.

2. As a result, Prudential's pre-tax income for 2000, 2001, and 2002 was overstated in its consolidated financial statements by $57 million or 9%, $75 million or 25%, and by $38 million or 146%, respectively. The company became a reporting company with its December 2001 initial public offering and its misstated results were contained in the company's subsequent periodic filings. As a result, Prudential violated the financial reporting, books-and-records and internal control provisions of the Securities Exchange Act of 1934 ("Exchange Act").

3. Prudential and Gen Re began their relationship with a riskless reinsurance contract negotiated by Prupac by 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 of 4.5% (in later years, 4.0%) 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 pay Gen Re back through future reinsurance contracts. 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.

4. 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 and timing the purported reinsurance contracts to recover virtually to the penny every payment it had made, plus interest, less Gen Re's fee.

5. Each contract was a sham, written to look like it met the requirements to qualify for reinsurance accounting but subject to an oral side agreement that effectively eliminated any risk to either party and made such accounting improper.

6. By virtue of the conduct described herein, Prudential, directly and indirectly, has engaged, and may again engage, in violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act [15 U.S.C. §§ 78m(a), 78m(b)(2)(A) and 78m(b)(2)(B)], and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder [17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-11 and 240.13a-13].

JURISDICTION AND VENUE

7. The Commission brings this action pursuant to the authority conferred upon it by Section 21(d)(1) of the Exchange Act [15 U.S.C. § 78u(d)(1)] and seeks a judgment permanently restraining and enjoining the defendant from engaging in the acts and practices alleged herein.

8. This Court has subject matter jurisdiction over this action pursuant to Sections 21(d)(1), 21(e) and 27 of the Exchange Act [15 U.S.C. §§ 78u(d)(1),78u(e), and 78aa].

9. Prudential, directly and indirectly, made use of the means or instrumentalities of interstate commerce, or of the mails, or the facilities of a national securities exchange, in connection with the transactions, acts, practices, and courses of business alleged in this complaint. Certain of these transactions, acts, practices, and courses of business occurred in the District of New Jersey, including, among other things, portions of the negotiations concerning the transactions described herein. Prudential also has its headquarters in Newark, New Jersey.

THE DEFENDANT

10. **Prudential** is a New Jersey corporation with its principal executive office in Newark, New Jersey. Since December 13, 2001, Prudential's securities have been registered with the Commission pursuant to Section 12(b) of the Exchange Act and Prudential's common stock has been traded on the New York Stock Exchange. Prudential Financial, Inc. is the successor to the Prudential Insurance Company of America, which converted from a mutual life insurance company owned by its policy holders to a public stock company on December 18, 2001. During the relevant period, Prupac, Prudential's property and casualty insurance subsidiaries, sold personal lines of property and casualty insurance in the U.S. retail market. Prupac was based in Holmdel, New Jersey, and was comprised of two companies, the Prudential Property and Casualty Insurance Company ("Prupac Indiana") and the Prudential Property and Casualty Insurance Company of New Jersey ("Prupac New Jersey"). Prupac Indiana was licensed in all states except New Jersey, while Prupac New Jersey was only licensed and did business in New Jersey. In the fourth quarter of 2003, Prudential sold the Prupac businesses in two cash transactions.

OTHER RELEVANT ENTITY

11. **General Reinsurance Corporation** is a Connecticut corporation with its principal corporate offices located in Stamford, Connecticut. Gen Re is one of the world's largest reinsurers, based on both premium revenues and capital. Gen Re became a wholly-owned subsidiary of Berkshire Hathaway Inc. on December 21, 1998. Berkshire Hathaway's Class A and Class B common stock are registered with the Commission pursuant to Section 12(b) of the Exchange Act.

FACTS

Overview

12. Beginning in the fourth quarter of 1997, Prupac entered into an arrangement with Gen Re for the express purpose of funding an off-balance sheet asset, which the parties generally referred to as a "finite bank," "bank," or "pot." The finite bank was available to offset losses in future periods in the event the company incurred large losses, or to otherwise boost earnings. Although Prupac's primary purpose in entering into the arrangement was initially to improve its results for 1998, over time the benefits of continuing to build the bank and defer drawing down on it became apparent. As a result, the bank was built up primarily in 1997, 1998, and 1999, and drawn down in 2000, 2001, and 2002, when the parties entered into purported reinsurance contracts structured so as to enable Prupac to recover under them and record over $200 million in income for those years.

13. In total, the five-year relationship between the parties involved approximately twenty-two supposedly unrelated reinsurance contracts, pursuant to which Prupac paid Gen Re $197 million in purported premiums and received back $218 million in purported reinsurance recoveries, with the difference accounted for by interest received and fees paid.

14. The individual contracts were all structured to look like legitimate finite reinsurance contracts, typically stop loss reinsurance policies or, in some cases, supplemental catastrophe covers ("cat covers"). Stop loss reinsurance policies are a form of excess of loss reinsurance in which a reinsurer indemnifies the insurer against the amount by which the insurer's incurred losses exceed an agreed-upon percentage of earned premium. Cat covers are a form of excess of loss reinsurance in which a reinsurer indemnifies the insurer for the amount of losses resulting from a catastrophic event or series of events in excess of a specified amount up to a particular coverage amount. Prupac and Gen Re used cat covers to provide Prupac with greater flexibility in its funding of the finite bank.

15. The terms of the individual stop loss contracts, some of which were for full years, some for half years, and others for individual quarters, varied widely. In general, the parties set the loss-ratio trigger higher in the contracts for 1997, 1998 and 1999 to help eliminate the risk that Gen Re would have to pay under those contracts and set it lower in the contracts for 2000, 2001 and 2002 to ensure that those policies did in fact pay off for Prupac.

16. The agreement to build a finite bank and protect each party against the risk of loss was not reflected in the written reinsurance contracts but rather took the form of an oral side agreement. Under the terms of the side agreement, all of the money Prupac paid to Gen Re under the contracts – or "ceded premium" – was to be repaid to Prupac in the future, plus interest and less fees to Gen Re, in the form of purported reinsurance recoveries. Although Gen Re collected approximately $8 million in fees over the course of the relationship, the written reinsurance contracts did not provide for such fees.

17. In the early years of the relationship before the amount in the finite bank was sufficient to cover Gen Re's apparent exposure on the reinsurance contracts, the oral side

agreement also provided that Gen Re was protected against loss on the contracts. The parties implemented this agreement primarily by entering into the purported reinsurance agreements at or near the end of the coverage period and setting loss ratio triggers so high that there would not be recoveries under the contract in excess of the amount in the finite bank. Moreover, Prupac executives and Gen Re orally agreed that, in the event Gen Re was required to pay recoveries in excess of the amount in the bank, Prupac would repay Gen Re.

18. The terms of the side agreement were set forth in a presentation Gen Re made to Prupac executives just before the first contract was entered into. The presentation clearly described the true purpose of the contracts, explaining that the arrangement would enable Prupac to "[d]efer excess asset accruals until Prupac [chose] to trigger recognition." Although the presentation acknowledged that a disadvantage of the proposed arrangement was "[h]andshake issues," it stated that Gen Re was "[c]ommit[ed] to handshakes."

19. The specific terms of the side agreement were set forth in a Gen Re slide titled "Understandings," which stated that: (i) Gen Re would collect a fee of 4.5% (later reduced to 4.0%) on payments made by Prupac; (ii) Gen Re would credit Prupac with interest on the amounts deposited with Gen Re at the one-year Treasury Bill rate; and (iii) there would be "reasonable amortization of deficit," meaning that Prupac would pay Gen Re back within a reasonable time should Gen Re suffer a loss in the early part of the relationship. These terms were further emphasized in another slide – titled "Experience Account Balance" – which described the mechanics of the experience balance account calculation.

20. The experience account balance was a meticulous accounting of the premiums paid by Prupac, minus Gen Re's fee, plus interest, and less any ceded losses, netting to an

"ending cash balance." The calculation was maintained by Gen Re and periodically shared with certain Prupac executives, and it was the basis for setting the terms of the individual contracts.

21. As a result of the oral side agreement, over the course of the relationship, Prupac recovered virtually to the penny every payment it made to Gen Re, plus interest, less Gen Re's fee. Despite the fact that Prupac's recoveries were thus the return in a round-trip of cash, Prupac characterized the repayments as "reinsurance recoveries" and treated them as income on its financial statements. Prupac's financial statements were consolidated with Prudential's financial statements.

The Establishment and Initial Funding of the Bank

22. With nine days left in 1997, Prupac and Gen Re entered into a stop loss agreement, backdated to October 1, that purported to cover up to $200 million in losses if Prupac's fourth quarter 1997 loss ratio exceeded 76% (the "Q4 97 contract"). At about the same time, the parties entered into a full-year 1998 contract.

23. Because Prupac purportedly paid $50 million in premium for $200 million of coverage, the Q4 97 contract appeared to transfer risk to Gen Re and thus be entitled to reinsurance accounting. In reality, however, at the time it was agreed to, the fourth quarter was almost over and it was known with virtual certainty that the loss ratio would not exceed 76% and thus that Prupac would not recover under the contract.

24. The Q4 97 contract was in fact designed to fund the full-year 1998 stop loss agreement, for which Prupac ostensibly paid only $2 million for $80 million in aggregate limits in excess of a 67% loss ratio. The true purpose of the Q4 97 contract was to help Prupac deliver a combined ratio of 98%, i.e. profitable underwriting operations, for 1998.

25. Prupac had been conceived as an adjunct to Prudential's life insurance business, the company's primary insurance business and had never been profitable. In 1996, new management had been installed at Prupac, with a mandate to turn it around. In the summer of 1997, high-level Prupac executives promised Prudential that Prupac would deliver "98 in '98," meaning a 98% combined ratio in 1998.

26. The Q4 97 contract was intended to take advantage of Prupac's unexpectedly high income for 1997 and help Prupac deliver on its promise of "98 in '98." In 1997, Prupac determined that it had excess reserves set aside for prior year loss development. That is, Prupac's losses from covered property and casualty events were turning out to be less severe than anticipated. As a result, Prupac "took down" prior year reserves of $107 million, which decreased its expenses and thus increased its income for 1997. Thus, Prupac had income to spare in 1997. Moreover, the subsidiary was under new management and was focused on its results for 1998, not 1997. Accordingly, certain Prupac executives conceived of the Q4 97 and full-year 1998 contracts – and the attendant side agreement – as a way to put away $50 million in 1997 that would be available to Prupac to achieve its goal of a 98 percent combined ratio in 1998.

27. The arrangement with Gen Re – the Q4 97 and full-year 1998 Prupac contracts as modified by the undisclosed side agreement – furthered the goal of a 98% combined ratio for 1998 because the bulk of the expense of the combined premiums on the two contracts – i.e., $50 million out of the combined $52 million – was allocated to 1997, rather than 1998. Had the full $52 million premium for the two contracts been properly allocated to 1998, or accrued over fifteen months (the three months of the Q4 97 contract and the twelve months of the 1998 contract), Prupac's 1998 costs would have increased, and thus, so would its combined ratio for the year. By accounting for the contracts separately, and accounting for them as reinsurance,

Prupac could use its excess income from 1997 to fund the 1998 contract, which had the real effect of protecting its 1998 results against any catastrophic loss that would have pushed its combined ratio above 98%. As long as the bulk of the cost of the 1998 contract could be expensed in 1997, absent a major catastrophe in 1998, Prupac was assured that it would meet the goal of "98 in 98."

28. A December 10, 1997 email between an executive and an employee at Prupac emphasized the importance of accounting for $50 million of the premium as a 1997 expense:

> [Prupac] has excess money due to the reserve take down this year so that's why we want to get $50 M into 97. The only way to have it written & earned is if we have the contract be only effective for 97, otherwise we'd have to earn it over the 15 months (10/1/97 to 12/31/97) and 97 [sic] would not get the benefit we're looking for. . . .

29. Gen Re took no risk on the Q4 97 contract. The risk of loss was limited because no agreement was reached until the final days of the coverage period. When they agreed to the substantive terms, the parties knew with a high degree of certainty that Prupac's loss ratio for the quarter would not trigger a recovery, as reflected in a December 16, 1997 internal email among high-level executives of Gen Re, which said "1997 is expected to have no underwriting loss, since the year is almost over." Moreover, the parties had agreed that Gen Re would return the premium payments to Prupac in future periods. The Q4 97 contract was thus a riskless arrangement, whose purpose was to fund the so-called experience account – or bank – for future periods.

30. In essence, the parties agreed to a round-trip arrangement. That agreement is reflected in the portions of Gen Re's presentation described in paragraphs 18 and 19 above. For example, an August 1998 internal email among executives at Gen Re discussing a 1998 contract states, "We would not enter into this cover without a commitment from Prupac for full payback." In a November 1998 email, an executive in Prudential's risk management department

acknowledged the payback obligation: "if we actually use the limit of the cover, we'll be in a pay back situation with Gen Re. . . ."

The True Terms of the Agreements Were Concealed from Prudential's Auditors

31. In order to achieve Prupac's goal of "98 in 98," it was crucial that Prudential's independent auditors agree that the Q4 97 and full-year 1998 contracts could be accounted for as separate reinsurance contracts and that the purported $50 million premium for the Q4 97 contract could be fully expensed in 1997.

32. The independent auditors initially believed that the two contracts should be combined, and accounted for as a single, fifteen-month deal, and that the appropriateness of reinsurance accounting had to be analyzed on that basis. Under generally accepted accounting principles ("GAAP"), whether a contract is properly accounted for as reinsurance depends on whether the contract transfers risk of loss or liability under one or more insurance contracts from the insurer to the reinsurer, and the analysis turns on substance rather than form.

33. To pass risk transfer, and to be able to expense the $50 million premium in 1997, Prupac executives therefore concluded that they needed to make a "strong argument" to the independent auditors that the contracts were separate. In furtherance of that argument, Prupac executives and Gen Re's executives concealed key facts from, and made misrepresentations to, the auditors.

34. Prupac executives involved did not disclose to the auditors that (i) the Q4 97 contract was not entered into until the end of the coverage period; (ii) was part of an arrangement whereby Gen Re agreed to return to Prupac in the future all the purported premium paid by Prupac in the form of purported reinsurance recoveries; (iii) and the true premium on the full-year 1998 contract was thus actually $52 million, not $2 million. Nor did they disclose that the

parties had agreed that the amount returned to Prupac would include accumulated interest, that Gen Re would receive a percentage of the ceded premiums as a fee, and that Gen Re would credit Prupac in the future for experience under prior contracts or that Prupac agreed to make Gen Re whole in the event Gen Re suffered a deficit on the transactions.

35. Prupac executives also made misrepresenations to the independent auditors about the timing of the Q4 97 contract and arranged for Gen Re to do so as well. High-level Prupac financial executives understood that the independent auditors had to be assured that the parties had "determined the significant terms of the [Q4 97] contract before 10/1/97 inception." A Prupac executive noted to the executive charged with assembling this proof: "[Gen Re] may be able to help if you don't have enough support in-house." Two days later, Gen Re provided the support Prupac needed: a letter dated January 8, 1998 which stated: "Enclosed please find a draft copy of the cat cover that we agreed to back in September." This statement was false – the agreement had been reached no earlier than December 22. The letter from Gen Re was provided to the auditors, who treated it as evidence "that the terms of the 1997 contract were substantially agreed to prior to October 1, 1997."

36. In addition, Prupac provided the independent auditors with a memorandum dated January 21, 1998 supporting separate treatment of the Q4 97 and 1998 contracts. The memorandum stated that the Q4 97 contract was agreed to prior to its effective date and that the 1997 and 1998 contracts were completely separate and no terms or conditions linked them together. With respect to risk transfer, the memorandum represented that – in accordance with GAAP – no contractual features limited Gen Re's risk, and specifically that the contracts did not contain any "experience refunds" that could limit Gen Re's risk. All of these representations were false.

37. Finally, in an April 22, 1998 representation letter to the auditors, high-level executives at Prupac represented that the Q4 97 contract had been agreed upon before the effective date, October 1, and that the two contracts were not linked economically. The letter stated:

> In 1997, the Company entered into an aggregate stop loss agreement covering the period October 1 through December 31; the significant terms of the agreement were agreed upon prior to the effective date. A second aggregate stop loss was entered into covering the period January 1, through December 31, 1998. The terms of each stop loss agreement were negotiated separately and the pricing reflects a reasonable premium for the coverage provided. The contracts meet the transfer of risk criteria and do not provide for experience rated refund of premiums based on loss activity. (emphasis added)

38. The representations as to the date the Q4 1997 contract was agreed upon were false and misled the independent auditors. In fact, the contract was negotiated together with the full-year 1998 contract and agreement on them was not reached until approximately December 22nd. The January memo and the letter to the auditors were also false and misleading because they failed to disclose the oral side agreement and falsely denied the existence of the experience account.

39. Because the Q4 97 and full-year 1998 contracts were in fact linked and subject to the oral side agreement, they were not in fact reinsurance and were not entitled to reinsurance accounting. Instead, they were simply a mechanism by which Prupac put away $50 million in one period for use in future periods. Accordingly, under GAAP, Prupac should not have treated as expense the amounts it paid Gen Re in the early years of the arrangement and should not have treated as income the amounts it received back from Gen Re in the later years.

40. By the time of the 1997 audit at least, the Prupac contracts with Gen Re had come to the attention of high-level executives in Prudential's finance department. In late 1997 or early 1998, these executives realized that Prudential had booked a $50 million expense that year for

reinsurance coverage for Prupac under which it would not recover. The Prudential executives came to understand that although there was no obligation in the written contracts for Gen Re to return Prupac's ceded premiums, the significant initial payments in 1997 and 1998 would benefit the company in subsequent periods and that Gen Re would not, as one executive put it, "stiff" Prupac.

Prupac Continued to Build the Bank in 1998 and 1999

41. In 1998, Prupac Indiana (which had been the party on the contracts described above) deposited more money in the bank, and Prupac New Jersey began a similar relationship with Gen Re whereby it took advantage of its unexpectedly good results that year to build a bank that it could draw down on to improve its results in future periods. Although Gen Re's exposure on the 1998 contracts theoretically exceeded the amount in the banks, in reality the parties set the triggers on the contracts high to avoid incurring a loss and, as with the previous contracts, Prupac executives agreed to pay Gen Re back in the event it did suffer a loss.

42. In the last six months of 1998, Prupac Indiana entered into a supplemental contract with Gen Re whereby it paid $40 million in premium for another $40 million of coverage – in addition to the $80 million already in place. This increased the total coverage for Prupac Indiana to $120 million for a total premium of $92 million (the $50 million purported premium on the Q4 97 stop-loss, the $2 million paid for the full-year 1998 stop loss contract and the $40 million paid for the 1998 supplemental contract). Although Gen Re still had a theoretical risk of losing $28 million on the combined contracts, the parties did not expect Prupac Indiana to actually make any claims on either the stop-loss contract or the supplemental contract and, even if it did, under the oral agreement between them Prupac would pay Gen Re back for any losses it incurred.

43. In the middle of 1998, when it became apparent that Prupac New Jersey would have an unexpectedly good year, Prupac New Jersey also began building a bank. It did this by simultaneously negotiating two quarterly contracts for 1998 and a full-year 1999 contract. Each of the two 1998 quarterly contracts provided for up to $75 million of coverage above a specified loss ratio and cost Prupac a total of $50 million in premium ($25 million per quarter). The full-year 1999 contract had a nominal premium of $2 million. As with the Q4 97 Prupac Indiana contract, the third quarter 1998 Prupac New Jersey contract was entered into just a few days before the end of the coverage period, making it virtually certain that the trigger would not be reached and Gen Re would not have to pay on the contract. However, Prupac represented to its independent auditors that the contract was agreed to prior to its inception date on July 1, 1998. This practice of entering into contracts at the very end of the coverage period was continued on several of the contracts throughout the relationship right up until the last contract in the third quarter of 2002.

44. Although the combined third and fourth quarter contracts might have appeared to transfer sufficient risk to Gen Re to qualify for reinsurance accounting, the risk apparently transferred was in fact eliminated because the parties set the loss ratio for each very high so that it would not be triggered and, even if it was triggered, Prupac agreed to pay Gen Re back if it suffered a loss.

45. The quarterly 1998 contracts thus allowed Gen Re to offer a full-year 1999 contract for which Prupac New Jersey ostensibly paid the nominal premium of $2 million for $70 million in coverage. Thus, the $50 million in "premium" payments by Prupac New Jersey in 1998 functioned as additional deposits into the bank.

46. The year ended December 31, 1998 proved to be a good enough year for both Prupac Indiana and Prupac New Jersey that Prupac was able to keep its promise of "98 in '98" without any recoveries from Gen Re. Thus, by the end of 1998, Prupac had paid a total of $142 million in purported premium – $92 million from Prupac Indiana and $50 million from Prupac New Jersey – into the finite bank and had not triggered one dollar in reinsurance recoveries.

47. In 1999, Gen Re provided coverage to Prupac in precisely the amount Prupac had already paid in past premium. Gen Re projected that by the end of 1999 there would be approximately $150 million available to Prupac in the finite bank. This figure became the limit on the coverage Gen Re would allow Prupac to purchase: Prupac Indiana received $80 million in coverage with a loss ratio trigger of 64% (for a nominal $2 million in premium) and Prupac New Jersey received $70 million in coverage with an 80% loss ratio (also for a nominal $2 million premium).

48. Throughout much of 1999 it appeared that Prupac would need to take back a large portion of the bank to meet aggressive income targets imposed on it by Prudential. In December 1998, Prudential increased Prupac's 1999 earnings target by $60 million, to $250 million from $190 million. In response, Prupac executives advised Prudential executives that, in order to achieve the new goal, Prupac would need to take one or more actions related to reserves and/or Prupac's stop loss coverage to hit the $250 million earnings target. As late as August 1999, Prudential continued to put heavy pressure on Prupac's management to increase earnings. However, Gen Re advised Prupac executives against taking back the bank at that time, arguing that Prudential could use the bank to buffer volatility in future periods.

49. Ultimately, Prudential chose not to recover on Prupac's contracts with Gen Re in 1999. Consequently, Prupac missed its internal earnings target by a wide margin. It recorded an

adjusted operating income of $150 million, $100 million short of the $250 million goal. The decision was designed to defer reaping the benefit of the arrangement with Gen Re to 2000 and beyond.

In 2000 and 2001, Prupac Began to Draw Down on the Bank

50. In 2000, consistent with the decision to defer recoveries from 1999 to future periods, Prupac began drawing down on the bank to help meet its income goals. Internal Prupac documents indicate that at year-end 1999 Prupac expected to "trigger aggregate stop loss for 2000, 2001 & 2002 to bring back some of the dollars paid." Prupac reported to high-level Prudential financial executives that in order to meet an increased earnings target it had increased its financial plan assumptions regarding 2000 reinsurance recoveries from $53 million to $99 million.

51. At the same time, Prupac reached out to inform Gen Re that it wanted 2000 contracts to be structured to permit a recovery, and to determine how much was available under the Prupac Indiana contract for 2000. Based on its calculation that there was a balance of approximately $102 million in the Prupac Indiana bank, Gen Re increased the limit on the Prupac Indiana coverage to $100 million ($20 more than the coverage for 1999). By Gen Re's calculations, Prupac's potential recovery under the arrangement was no more than the amount in the bank, and the 2000 recovery under Prupac Indiana's stop loss agreement was accordingly pre-paid. Shortly afterwards, Prupac Indiana and Gen Re entered into a 2000 stop loss agreement with a significantly lower loss ratio than prior contracts, 59% – compared to 76%, 67% and 64%, respectively, for the 1997, 1998 and 1999 contracts – making a recovery under the 2000 contract a virtual certainty.

52. As the year 2000 progressed, Prupac decided that it wanted the option of taking in additional recoveries to achieve the increased income target imposed on it by Prudential. Accordingly, in September 2000 Prupac requested that the limit on the Prupac Indiana stop loss contract be further increased from $100 million to $120 million. To do so, Prupac suggested that Gen Re combine the Prupac Indiana and Prupac New Jersey "pots" to allow for a higher limit on the Prupac Indiana coverage. It was not until the last week of November that Gen Re responded, telling Prupac that the increased limit was acceptable. At that point the Prupac Indiana bank held $106 million, and because the coverage period and catastrophe season were essentially over, Gen Re determined that there was no risk that it would realize a deficit on the Indiana contract. Moreover, according to Gen Re's calculations, the Prupac New Jersey bank held approximately $100 million at that point, and no losses would be reported on the New Jersey stop loss contract. Accordingly, as confirmed by contemporaneous documents, even with the increase, Gen Re believed that it had "no net exposure on the current balance and coverage."

53. Ultimately, Prupac recovered $97 million on the 2000 stop loss agreement, all through the Prupac Indiana contracts. It recorded the recovery as a reinsurance recoverable and included it in its reported income for 2000, which was reported in Prudential's financial statements included in its Form 10-K for the year ended December 31, 2001. (In its discussion of the recoveries in the Management Discussion and Analysis sections of its Form 10-K for 2001, Prudential quantified the amount of the recovery for 2000 as $80 million.)

54. Because the "recovery" was in fact simply the return of monies Prupac had banked with Gen Re, treating the recoverable as income was inconsistent with GAAP. Thus, Prudential overstated its 2000 pre-tax income, on a net basis, by $57 million or 9%.

55. Prupac continued to trigger recoveries in 2001. That year, Prupac sought $80 million of coverage (for a nominal premium of $2 million) for Prupac Indiana and $50 million of coverage (for a nominal premium of $1.5 million) for Prupac New Jersey, for a total coverage amount of $130 million.

56. There was a problem with Prupac's plan, however, because the amount in the bank was uncertain. The parties were negotiating the 2001 agreements in late 2000 and early 2001, but Prupac's total recoveries under the 2000 contracts would not be known until 120 days after the end of the coverage period, which was May 1, 2001. Gen Re therefore wanted confirmation that Prupac was ceding only $80 million in losses, not the full $120 million on the Prupac Indiana contract, before agreeing to terms for the 2001 contracts. Accordingly, Prupac and Gen Re agreed that they would wait for the final numbers for 2000 before finalizing the 2001 coverage.

57. In May 2001, Prupac finalized its 2000 loss calculations, and determined its final recovery under the stop loss was $97 million, $17 million more than the $80 million it had anticipated. This reduced the Prupac Indiana bank available for 2001 to approximately $13 million. As a result, in order to offer the $80 million limit Prupac sought for Prupac Indiana for 2001, Gen Re needed to combine the Prupac Indiana and Prupac New Jersey banks, which together totaled about $130 million. In June 2001, Gen Re's executives reconfirmed that the Prupac New Jersey bank would subsidize any recoveries paid under the Prupac Indiana contract and, after calculating that the amount in the finite bank available for 2001 was $131.5 million, provided the full $80 million coverage Prupac Indiana had requested.

58. As anticipated, in 2001 Prupac recovered the full amount of the $80 million contract for Prupac Indiana, which had been set to trigger at a loss ratio of 61%. Prupac recorded

the recovery as income. The net effect of this improper accounting for the transactions with Gen Re was to understate Prudential's pre-tax loss for 2001 by $75 million, or 25%.

In 2002, by Meticulously Monitoring the Bank and Structuring the Contracts, Prupac Took Back the Remainder of the Bank

59. As early as June 2001, Prupac executives were evaluating how they could best use the amount remaining in the bank, and whether to structure a 2002 recovery to boost income. In a June 2001 Prupac draft forecast analysis prepared for high-level Prudential executives, Prupac warned of a $30 million income shortfall for 2002 if it did not "release into earnings . . . the remaining amount in our stop loss reinsurance account," which was then approximately $25 million. Prupac subsequently advised Prudential executives that it intended to "fully deplete[] [the] 'bank' including interest earned."

60. When structuring 2002 coverage, Prupac wanted greater flexibility. As a result, Prupac and Gen Re executives agreed to change the contract structure from annual coverage to quarterly coverage, which enhanced Prupac's flexibility to trigger recoveries or defer taking back the bank to a later period. In addition, Prupac and Gen Re agreed to write one contract that covered both Prupac Indiana and Prupac New Jersey to ensure that the payments made into the Prupac New Jersey "pot" could be used to pay for the recoveries, which Prupac determined to take through Prupac Indiana.

61. By late December 2001, the parties estimated that the amount in the bank available for 2002 was $37 million. The parties agreed to set the limit on the first quarter coverage at $30 million, and to set the loss ratio trigger at 66.5%, low enough to ensure a sizeable recovery. Prupac recovered $20 million under the first quarter 2002 contract, leaving, by Gen Re's calculation, approximately $20 million in the bank.

62. For the second quarter, Gen Re offered a contract with a $15 million limit, leaving approximately $5 million in the bank. The trigger was lowered to 65.5% to ensure that Prupac recovered the full amount under the second quarter contract, which it did.

63. By the third quarter of 2002, there was approximately $6.7 million left in the bank. In August 2002, Gen Re faxed Prupac a full accounting of the finite bank from inception in the fourth quarter of 1997 through August 30, 2002 – including calculations of Gen Re's fee, total interest accrued, and the net ending cash balance. Also included was a handwritten calculation netting case reserves – the amount Gen Re was obligated to pay Prupac under the contracts – against total premium payments and interest, resulting in a net amount available of $6,675,581.

64. In late September 2002, three days before the end of the coverage period, Prupac and Gen Re executed the final contract purportedly covering the third quarter of 2002. This contract provided $6.5 million of coverage in excess of a 66.5% loss ratio, purportedly in exchange for a premium of $750,000. As anticipated, Prupac made a full recovery under the third quarter contract, or $6.5 million. As in the past, Prupac accounted for the transaction as a reinsurance recovery and Prudential reported it as such in its consolidated financial statements.

65. Thus, by meticulously monitoring the bank in 2002, Prupac and Gen Re were able to tailor the three quarterly contracts to return – nearly to the dollar – the full amount Prupac had on deposit with Gen Re.

<u>Prudential Filed Inaccurate Financial Statements with the Commission</u>

66. On December 12, 2001, Prudential became a public company. Since December 13, 2001, Prudential's securities have been registered with the Commission pursuant to Section

12(b) of the Exchange Act and Prudential's common stock has been traded on the New York Stock Exchange.

67. On March 26, 2002, Prudential filed its Form 10-K containing its financial statements for the year ended December 31, 2001. In its consolidated income statement, Prudential reported pre-tax loss of $227 million for the year ended December 31, 2001, which improperly included as income an $80 million recovery from Prupac's reinsurance policy with Gen Re and thus understated it. In this filing, Prudential also improperly characterized the recovery as reinsurance proceeds, and identified the source of the income as stop loss agreements. The net effect of its improper accounting for the recoveries from Gen Re was to understate Prudential's pre-tax loss for 2001 by $75 million, or 25%.

68. Prudential filed Form 10-Qs containing its consolidated financial statements for the first three quarters of 2002 on May 15, August 14 and November 14, respectively. In its first quarter consolidated income statements, Prudential reported pre-tax income of $244 million; for the second quarter it reported a pre-tax loss of $109 million; and for the third quarter it reported pre-tax income of $129 million. These amounts improperly included income from Prupac's reinsurance policies with Gen Re of $20 million, $15 million and $7 million, respectively. As a result, Prudential's first quarter income was overstated by $19 million, or 8%, its second quarter pre-tax loss was understated by $14 million, or 11%, and its third quarter pre-tax income was overstated by $6 million, or 5%.

69. On March 14, 2003, Prudential filed its Form 10-K containing its financial statements for the year ended December 31, 2002. In its consolidated income statement, Prudential reported pre-tax income of $64 million for the year ended December 31, 2002. This

figure improperly included as income a $41 million recovery from Prupac's reinsurance policies with Gen Re and thus was overstated by, on a net basis, $26 million or 146%.

70. Inaccurate financial information was also contained in earnings releases contained in Forms 8-K Prudential filed in 2001 and 2002, including Forms 8-K filed on February 13, 2002; May 7, 2002; August 6, 2002; November 5, 2002; and February 11, 2003.

71. In all of the above filings, Prudential improperly treated the recoveries from Gen Re as income, characterized the recoveries as reinsurance proceeds, and identified the source of the income as stop loss agreements.

72. The effect of Prudential's improper accounting on its reported results was to understate pre-tax income in 1997, 1998 and 1999 and significantly overstate pre-tax income in 2000, 2001 and 2002, as shown below:

Impact of Improper Accounting on Prudential's Selected Results
For the Years Ended December 31, 1997 through 2002

(in millions)	1997	1998	1999	2000	2001	2002
Reported income (loss) from continuing operations before taxes	$1,370	$2,597	$2,255	$727	$(227)	$64
Adjustments						
To record premium expense as deposit	50	92	13	36	4	2
To record interest income on deposit	2	6	7	4	1	1
To reverse benefit of stop loss recorded as reinsurance	-	-	-	(97)	(80)	(41)
Net effect of improper accounting	52	98	20	(57)	(75)	(38)
Adjusted income (loss) from continuing operations before taxes	$1,422	$2,695	$2,275	$670	$(302)	$26
(Under)/Overstatement %	(4%)	(4%)	(1%)	9%	(25%)	146%

FIRST CLAIM FOR RELIEF

(Violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13)

73. The Commission realleges and incorporates by reference herein each and every allegation contained in paragraphs 1 through 72, above.

74. As described above, Prudential failed to file with the Commission such financial reports as the Commission has prescribed, and failed to include, in addition to the information expressly required to be stated in such reports, such further material information as was necessary to make the statements made therein, in light of the circumstances in which they were made, not misleading.

75. By reason of the foregoing, Prudential violated, and unless enjoined, will continue to violate, Section 13(a) of the Exchange Act [15 U.S.C. § 78m(a)] and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder [17 C.F.R. §§ 240.12b-20, 240.13a.1, 240.13a-11, and 240.13a-13].

SECOND CLAIM FOR RELIEF

(Violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act)

76. The Commission realleges and incorporates by reference herein each and every allegation contained in paragraphs 1 through 72, above.

77. As described above, Prudential failed to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflected the transactions and dispositions of its assets, and failed to maintain a system of internal accounting controls that permitted the preparation of financial statements in conformity with GAAP.

78. By reason of the foregoing, Prudential violated, and unless enjoined, will continue to violate, Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act [15 U.S.C. §§ 78m(b)(2)(A) and 78m(b)(2)(B)].

PRAYER FOR RELIEF

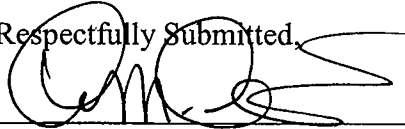
WHEREFORE, the Commission respectfully requests that this Court:

1. Enter a Final Judgment permanently restraining and enjoining defendant Prudential, its officers, agents, servants, employees, attorneys, and all persons in active concert or participation with them who receive actual notice of the injunction by personal service or otherwise, and each of them, from, directly or indirectly, violating Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act [15 U.S.C. §§ 78m(a), 78m(b)(2)(A) and 78m(b)(2)(A)(B)] and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder [17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-11, and 240.13a-13]; and

2. Grant such other and further relief as the Court deems appropriate.

Dated: August 6, 2008
New York, New York

Respectfully Submitted,



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Certification

Pursuant to Local Rule 11.2, I certify that the matter in controversy alleged in the foregoing Complaint is not the subject of any other action pending in any court, or of any pending arbitration or administrative proceeding.

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