

# PRUCO LIFE INSURANCE COMPANY OF NEW JERSEY

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# Pruco Life Insurance Company of New Jersey

## Statements of Financial Position

As of December 31, 2010 and 2009 (in thousands, except share amounts)

	<u>2010</u>	<u>2009</u>
<b>ASSETS</b>		
Fixed maturities available for sale, at fair value (amortized cost, 2010 - \$ 1,007,655; 2009 - \$1,028,386)	\$1,064,541	\$1,054,380
Equity securities available for sale, at fair value (cost, 2010 - \$2,301; 2009 - \$4,003)	2,074	3,826
Policy loans	175,514	169,835
Short-term investments	7,409	27,976
Commercial mortgage loans	182,437	167,935
Other long-term investments	16,913	8,309
Total investments	1,448,888	1,432,261
Cash and cash equivalents	87,961	32,601
Deferred policy acquisition costs	365,970	305,617
Accrued investment income	16,365	16,833
Reinsurance recoverables	419,858	322,530
Receivables from parent and affiliates	25,833	33,511
Deferred sales inducements	51,106	30,265
Other assets	8,293	4,861
Separate account assets	5,038,051	3,261,890
<b>TOTAL ASSETS</b>	<u>\$7,462,325</u>	<u>\$5,440,369</u>
<b>LIABILITIES AND EQUITY</b>		
<b>LIABILITIES</b>		
Policyholders' account balances	\$1,053,807	\$1,025,018
Future policy benefits and other policyholder liabilities	503,354	460,433
Cash collateral for loaned securities	413	21,132
Securities sold under agreement to repurchase	2,957	11,540
Income taxes payable	120,248	97,284
Short-term debt to affiliates	-	-
Payables to parent and affiliates	5,837	4,194
Other liabilities	109,969	45,226
Separate account liabilities	5,038,051	3,261,890
<b>Total liabilities</b>	<u>\$6,834,636</u>	<u>\$4,926,717</u>
<b>COMMITMENTS AND CONTINGENT LIABILITIES (See Note 12)</b>		
<b>EQUITY</b>		
Common stock, (\$10 par value; 1,000,000 shares, authorized; 250,000 shares, issued and outstanding)	2,000	2,000
Additional paid-in capital	169,742	168,998
Retained earnings	430,663	332,718
Accumulated other comprehensive income	25,284	9,936
<b>Total equity</b>	<u>627,689</u>	<u>513,652</u>
<b>TOTAL LIABILITIES AND EQUITY</b>	<u>\$7,462,325</u>	<u>\$5,440,369</u>

See Notes to Financial Statements

## Pruco Life Insurance Company of New Jersey

### Statements of Operations and Comprehensive Income Years Ended December 31, 2010, 2009 and 2008 (in thousands)

	<u>2010</u>	<u>2009</u>	<u>2008</u>
<b>REVENUES</b>			
Premiums	\$ 14,733	\$ 17,031	\$ 14,903
Policy charges and fee income	53,446	69,234	75,712
Net investment income	77,044	69,944	68,001
Asset administration fees	11,084	7,114	7,395
Other income	4,915	4,779	5,154
Realized investment gains/(losses), net:			
Other-than-temporary impairments on fixed maturity securities	(21,166)	(14,461)	(9,149)
Other-than-temporary impairments on fixed maturity securities transferred to Other Comprehensive Income	18,612	8,391	-
Other realized investment gains (losses), net	<u>59,567</u>	<u>19,584</u>	<u>(17,806)</u>
Total realized investment gains (losses), net	<u>57,015</u>	<u>13,514</u>	<u>(26,955)</u>
<b>Total revenues</b>	<u>218,237</u>	<u>181,616</u>	<u>144,210</u>
<b>BENEFITS AND EXPENSES</b>			
Policyholders' benefits	(198)	26,062	30,454
Interest credited to policyholders' account balances	37,125	38,735	30,684
Amortization of deferred policy acquisition costs	12,821	22,842	21,812
General, administrative and other expenses	<u>27,002</u>	<u>17,950</u>	<u>35,437</u>
<b>Total benefits and expenses</b>	<u>76,750</u>	<u>105,589</u>	<u>118,387</u>
Income from operations before income taxes	141,487	76,027	25,823
Income Taxes:			
Current	23,841	20,362	1,033
Deferred	<u>19,701</u>	<u>644</u>	<u>3,085</u>
Income tax expense	<u>43,542</u>	<u>21,006</u>	<u>4,118</u>
<b>NET INCOME</b>	<u>97,945</u>	<u>55,021</u>	<u>21,705</u>
Change in net unrealized investment gains/(losses) and changes in foreign currency translation, net of taxes	<u>15,348</u>	<u>44,313</u>	<u>(33,826)</u>
<b>COMPREHENSIVE INCOME (LOSS)</b>	<u>\$113,293</u>	<u>\$ 99,334</u>	<u>\$ (12,121)</u>

See Notes to Financial Statements

## Pruco Life Insurance Company of New Jersey

### Statements of Stockholder's Equity

Years Ended December 31, 2010, 2009 and 2008 (in thousands)

	Common Stock	Additional Paid-in- Capital	Retained Earnings	Total Accumulated Other Comprehensive Income (Loss)	Total Equity
<b>Balance, December 31, 2007</b>	\$2,000	\$168,998	\$252,259	\$ 3,182	\$426,439
Net Income	-	-	21,705	-	21,705
Change in foreign currency translation adjustments, net of taxes	-	-	-	(82)	(82)
Change in net unrealized investment gains/(losses), net of taxes	-	-	-	(33,744)	(33,744)
<b>Balance, December 31, 2008</b>	\$2,000	\$168,998	\$273,964	\$(30,644)	\$414,318
Net income			55,021		55,021
Change in foreign currency translation adjustments, net of taxes	-	-	-	40	40
Impact of adoption of new guidance for other-than-temporary impairments of debt securities, net of taxes	-	-	3,733	(3,733)	-
Change in net unrealized investment gains/(losses), net of taxes	-	-	-	44,273	44,273
<b>Balance, December 31, 2009</b>	\$2,000	\$168,998	\$332,718	\$ 9,936	\$513,652
Net income			97,945		97,945
Affiliated Asset Transfers	-	744	-	-	744
Change in foreign currency translation adjustments, net of taxes	-	-	-	(22)	(22)
Change in net unrealized investment gains/(losses), net of taxes	-	-	-	15,370	15,370
<b>Balance, December 31, 2010</b>	\$2,000	\$169,742	\$430,663	\$ 25,284	\$627,689

See Notes to Financial Statements

# Pruco Life Insurance Company of New Jersey

## Statements of Cash Flows

Years Ended December 31, 2010, 2009 and 2008 (in thousands)

	<u>2010</u>	<u>2009</u>	<u>2008</u>
<b>CASH FLOWS FROM (USED IN) OPERATING ACTIVITIES:</b>			
Net income	\$ 97,945	\$ 55,021	\$ 21,705
Adjustments to reconcile net income to net cash from (used in) operating activities:			
Policy charges and fee income	(13,471)	(15,597)	(20,623)
Interest credited to policyholders' account balances	37,125	38,735	30,685
Realized investment losses/(gains), net	(57,015)	(13,514)	26,955
Amortization and other non-cash items	(3,906)	(271)	(1,115)
Change in:			
Future policy benefits and other policyholders' liabilities	90,575	71,430	85,986
Reinsurance recoverable	(97,731)	(65,542)	(66,008)
Accrued investment income	468	(1,809)	(842)
Receivables from parent and affiliates	(6,108)	15,115	(4,125)
Payable to parent and affiliates	1,643	(5,628)	1,518
Deferred policy acquisition costs	(72,689)	(34,550)	(11,286)
Income taxes payable	14,700	6,631	(1,323)
Deferred sales inducements	(21,594)	(8,689)	(6,959)
Other, net	15,508	(8,965)	(7,400)
<b>CASH FLOWS FROM (USED IN) OPERATING ACTIVITIES</b>	<u>(14,550)</u>	<u>32,367</u>	<u>47,168</u>
<b>CASH FLOWS FROM (USED IN) INVESTING ACTIVITIES:</b>			
Proceeds from the sale/maturity/prepayment of:			
Fixed maturities available for sale	211,850	254,335	248,848
Policy loans	17,827	20,554	18,682
Commercial mortgage loans	28,189	10,212	2,571
Equity securities	2,000	-	-
Payments for the purchase of:			
Fixed maturities available for sale	(190,281)	(412,550)	(234,739)
Policy loans	(15,966)	(13,030)	(14,948)
Commercial mortgage loans	(41,700)	(31,684)	(44,424)
Equity securities	(158)	-	-
Notes receivable from parent and affiliates, net	13,926	2,907	(3,417)
Other long term investments, net	(6,698)	850	(1,870)
Short term investments, net	20,569	(19,825)	4,227
<b>CASH FLOWS FROM (USED IN) INVESTING ACTIVITIES</b>	<u>39,558</u>	<u>(188,231)</u>	<u>(25,070)</u>
<b>CASH FLOWS FROM (USED IN) FINANCING ACTIVITIES:</b>			
Policyholders' account deposits	171,435	335,906	209,422
Policyholders' account withdrawals	(151,600)	(213,085)	(133,752)
Net change in securities sold under agreement to repurchase and cash collateral for loaned securities	(29,304)	(5,954)	(2,054)
Contribution from parent	10	-	-
Net change in financing arrangements (maturities 90 days or less)	39,811	1,787	(59,088)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>	<u>30,352</u>	<u>118,654</u>	<u>14,528</u>
Net increase (decrease) in cash and cash equivalents	55,360	(37,210)	36,626
Cash and cash equivalents, beginning of year	32,601	69,811	33,185
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<u>\$ 87,961</u>	<u>\$ 32,601</u>	<u>\$ 69,811</u>
<b>SUPPLEMENTAL CASH FLOW INFORMATION</b>			
Income taxes paid	\$ 28,842	\$ 14,375	\$ 5,441
Interest paid	\$ 4	\$ 7	\$ 556

See Notes to Financial Statements

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

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### 1. BUSINESS AND BASIS OF PRESENTATION

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

Beginning in March 2010, Prudential Annuities Life Assurance Corporation (“PALAC”), an affiliate of the Company, ceased offering its existing variable annuity products (and where offered, the companion market value adjustment option) to new investors upon the launch of a new product in Pruco Life Insurance Company of New Jersey. In general, the new product line offers the same optional living benefits and optional death benefits as offered by PALAC’s existing variable annuities. However, subject to applicable contractual provisions and administrative rules, PALAC will continue to accept subsequent purchase payments on in force contracts under existing annuity products. These initiatives were implemented to create operational and administrative efficiencies by offering a single product line of annuity products from a more limited group of legal entities. In addition, by limiting its variable annuity offerings to a single product line sold through one insurer the Prudential Annuities business unit of Prudential Financial expects to convey a more focused, cohesive image in the marketplace.

#### *Basis of Presentation*

The Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”).

The Company has extensive transactions and relationships with Prudential Insurance and other affiliates, (as more fully described in Note 13 to the Financial Statements). Due to these relationships, it is possible that the terms of these transactions are not the same as those that would result from transactions among wholly unrelated parties.

#### *Use of Estimates*

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

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

#### *Reclassifications*

Certain amounts in prior periods have been reclassified to conform to the current period presentation.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### *Investments in Debt and Equity Securities*

The Company’s investments in debt and equity securities include fixed maturities, equity securities, and short-term investments. The accounting policies related to each are as follows:

**Fixed maturities** are comprised of bonds, notes and redeemable preferred stock. Fixed maturities classified as “available for sale” are carried at fair value. See Note 10 for additional information regarding the determination

# **Pruco Life Insurance Company of New Jersey**

## **Notes to Financial Statements**

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### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

of fair value. Interest income, as well as the related amortization of premium and accretion of discount is included in "Net investment income" under the effective yield method. For mortgage-backed and asset-backed securities, the effective yield is based on estimated cash flows, including prepayment assumptions based on data from widely accepted third-party data sources or internal estimates. In addition to prepayment assumptions, cash flow estimates vary based on assumptions regarding the underlying collateral, including default rates and changes in value. These assumptions can significantly impact income recognition and the amount of other-than-temporary impairments recognized in earnings and other comprehensive income. For high credit quality mortgage-backed and asset-backed securities (those rated AA or above), cash flows are provided quarterly, and the amortized cost and effective yield of the security are adjusted as necessary to reflect historical prepayment experience and changes in estimated future prepayments. The adjustments to amortized cost are recorded as a charge or credit to net investment income in accordance with the retrospective method. For asset-backed and mortgage-backed securities rated below AA, the effective yield is adjusted prospectively for any changes in estimated cash flows. See the discussion below on realized investment gains and losses for a description of the accounting for impairments, as well as the impact of the Company's adoption on January 1, 2009 of new authoritative guidance for the recognition and presentation of other-than-temporary impairments for debt securities. Unrealized gains and losses on fixed maturities classified as "available for sale," net of tax, and the effect on deferred policy acquisition costs, deferred sales inducements, future policy benefits that would result from the realization of unrealized gains and losses, are included in "Accumulated other comprehensive income (loss)."

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

**Commercial mortgage loans** consist of commercial mortgage loans and agricultural loans. Commercial mortgage loans are broken down by class which is based on property type (industrial properties, retail, office, multi-family/apartment, hospitality, and other).

Commercial mortgage loans originated and held for investment are generally carried at unpaid principal balance, net of an allowance for losses.

Interest income, as well as prepayment fees and the amortization of the related premiums or discounts, related to commercial mortgage and other loans, are included in "Net investment income."

Impaired loans include those loans for which it is probable that amounts due according to the contractual terms of the loan agreement will not all be collected. The Company defines "past due" as principal or interest not collected at least 30 days past the scheduled contractual due date. Interest received on impaired loans, including loans that were previously modified in a troubled debt restructuring, is either applied against the principal or reported as net investment income based on the Company's assessment as to the collectability of the principal. See Note 3 for additional information about the Company's past due loans.

# **Pruco Life Insurance Company of New Jersey**

## **Notes to Financial Statements**

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### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

The Company discontinues accruing interest on impaired loans after the loans become 90 days delinquent as to principal or interest payments, or earlier when the Company has doubts about collectability. When a loan is deemed to be impaired, any accrued but uncollectible interest on the impaired loan and other loans backed by the same collateral, if any, is charged to interest income in the period the loan is deemed to be impaired. Generally, a loan is restored to accrual status only after all delinquent interest and principal are brought current and, in the case of loans where the payment of interest has been interrupted for a substantial period, a regular payment performance has been established.

The Company reviews the performance and credit quality of the commercial mortgage loan and agricultural loan portfolios on an on-going basis. Loans are placed on watch list status based on a predefined set of criteria and are assigned one of three categories. Loans are placed on “early warning” status in cases where, based on the Company’s analysis of the loan’s collateral, the financial situation of the borrower or tenants or other market factors, it is believed a loss of principal or interest could occur. Loans are classified as “closely monitored” when it is determined that there is a collateral deficiency or other credit events that may lead to a potential loss of principal or interest. Loans “not in good standing” are those loans where the Company has concluded that there is a high probability of loss of principal, such as when the loan is delinquent or in the process of foreclosure. As described below, in determining our allowance for losses, the Company evaluates each loan on the watch list to determine if it is probable that amounts due according to the contractual terms of the loan agreement will not be collected.

Loan-to-value and debt service coverage ratios are measures commonly used to assess the quality of commercial mortgage loans. The loan-to-value ratio compares the amount of the loan to the fair value of the underlying property collateralizing the loan, and is commonly expressed as a percentage. Loan-to-value ratios greater than 100% indicate that the loan amount exceeds the collateral value. A smaller loan-to-value ratio indicates a greater excess of collateral value over the loan amount. The debt service coverage ratio compares a property’s net operating income to its debt service payments. Debt service coverage ratios less than 1.0 times indicate that property operations do not generate enough income to cover the loan’s current debt payments. A larger debt service coverage ratio indicates a greater excess of net operating income over the debt service payments. The values utilized in calculating these ratios are developed as part of the Company’s periodic review of the commercial mortgage loan and agricultural loan portfolio, which includes an internal appraisal of the underlying collateral value. The Company’s periodic review also includes a quality re-rating process, whereby the internal quality rating originally assigned at underwriting is updated based on current loan, property and market information using a proprietary quality rating system. The loan-to-value ratio is the most significant of several inputs used to establish the internal credit rating of a loan which in turn drives the allowance for losses. Other key factors considered in determining the internal credit rating include debt service coverage ratios, amortization, loan term, estimated market value growth rate and volatility for the property type and region. See Note 3 for additional information related to the loan-to-value ratios and debt service coverage ratios related to the Company’s commercial mortgage and agricultural loan portfolios.

Loans are reported at carrying value, and the allowance for losses includes a loan specific reserve for each impaired loan that has a specifically identified loss and a portfolio reserve for probable incurred but not specifically identified losses. For impaired commercial mortgage loans and agricultural loans the allowances for losses are determined based on the present value of expected future cash flows discounted at the loan’s effective interest rate, or based upon the fair value of the collateral if the loan is collateral dependent. The portfolio reserves for probable incurred but not specifically identified losses in the commercial mortgage and agricultural loan portfolio segments considers the current credit composition of the portfolio based on an internal quality rating, (as described above). The portfolio reserves are determined using past loan experience, including

# **Pruco Life Insurance Company of New Jersey**

## **Notes to Financial Statements**

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### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

historical credit migration, default probability and loss severity factors by property type. Historical credit migration, default and loss severity factors are updated each quarter based on the Company's actual loan experience, and are considered together with other relevant qualitative factors in making the final portfolio reserve calculations.

The allowance for losses on commercial mortgage loans and agricultural loans can increase or decrease from period to period based on the factors noted above. "Realized investment gains (losses), net" includes changes in the allowance for losses and changes in value for loans accounted for under the fair value option. "Realized investment gains (losses), net" also includes gains and losses on sales, certain restructurings, and foreclosures.

When a commercial mortgage or other loan is deemed to be uncollectible, any specific valuation allowance associated with the loan is reversed and a direct write down to the carrying amount of the loan is made. The carrying amount of the loan is not adjusted for subsequent recoveries in value.

**Policy loans** are carried at unpaid principal balances. Interest income on policy loans is recognized in "Net investment income" at the contract interest rate when earned.

**Securities repurchase and resale agreements and securities loaned** transactions are used to earn spread income, to borrow funds, or to facilitate trading activity. Securities repurchase and resale agreements are generally short term in nature, and therefore, the carrying amounts of these instruments approximate fair value. As part of securities repurchase agreements or securities loan transactions the Company transfers U.S. government and government agency securities and receives cash as collateral. As part of securities resale agreements, the Company transfers cash as collateral and receives U.S. government securities. For securities repurchase agreements and securities loaned transactions used to earn spread income, the cash received is typically invested in cash equivalents, short term investments or fixed maturities.

Securities repurchase and resale agreements that satisfy certain criteria are treated as collateralized financing arrangements. These agreements are carried at the amounts at which the securities will be subsequently resold or reacquired, as specified in the respective agreements. For securities purchased under agreements to resell, the Company's policy is to take possession or control of the securities and to value the securities daily. Securities to be resold are the same, or substantially the same, as the securities received. For securities sold under agreements to repurchase, the market value of the securities to be repurchased is monitored, and additional collateral is obtained where appropriate, to protect against credit exposure. Securities to be repurchased are the same, or substantially the same as those sold. Income and expenses related to these transactions executed within the insurance subsidiary used to earn spread income are reported as "Net investment income," however, for transactions used to borrow funds, the associated borrowing cost is reported as interest expense (included in "General, administrative and other expenses").

**Securities loaned transactions** are treated as financing arrangements and are recorded at the amount of cash received. The Company obtains collateral in an amount equal to 102% and 105% of the fair value of the domestic and foreign securities, respectively. The Company monitors the market value of the securities loaned on a daily basis with additional collateral obtained as necessary. Substantially all of the Company's securities loaned transactions are with large brokerage firms. Income and expenses associated with securities loaned transactions used to earn spread income are generally reported as "Net investment income;" however, for securities loaned transactions used for funding purposes the associated rebate is reported as interest expense (included in "General, administrative and other expenses").

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

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### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

**Other long term investments** consist of derivatives, the Company's investments in joint ventures and limited partnerships in which the Company does not exercise control, as well as investments in the Company's own separate accounts, which are carried at fair value, and investment real estate. Joint venture and partnership interests are generally accounted for using the equity method of accounting, except in instances in which the Company's interest is so minor that it exercises virtually no influence over operating and financial policies. In such instances, the Company applies the cost method of accounting. The Company's share of net income from investments in joint ventures and partnerships is generally included in "Net investment income."

**Short-term investments** primarily consist of highly liquid debt instruments with a maturity of greater than three months and less than twelve months when purchased. These investments are generally carried at fair value and include certain money market investments, short-term debt securities issued by government sponsored entities and other highly liquid debt instruments.

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

Realized investment gains and losses are also generated from prepayment premiums received on private fixed maturity securities, recoveries of principal on previously impaired securities, provisions for losses on commercial mortgage and fair value changes on embedded derivatives and free-standing derivatives that do not qualify for hedge accounting treatment.

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

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

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

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### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

the net present value if it believes that the security is dependent on the liquidation of collateral for recovery of its investment. If the net present value is less than the amortized cost of the investment, an other-than-temporary impairment is recognized. In addition to the above mentioned circumstances, the Company also recognizes an other-than-temporary impairment in earnings when a foreign currency denominated security in an unrealized loss position approaches maturity.

Under the authoritative guidance for the recognition and presentation of other-than-temporary impairments, when an other-than-temporary impairment of a debt security has occurred, the amount of the other-than-temporary impairment recognized in earnings depends on whether the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis. If the debt security meets either of these two criteria, the other-than-temporary impairment recognized in earnings is equal to the entire difference between the security's amortized cost basis and its fair value at the impairment measurement date. For other-than-temporary impairments of debt securities that do not meet these two criteria, the net amount recognized in earnings is equal to the difference between the amortized cost of the debt security and its net present value calculated as described above. Any difference between the fair value and the net present value of the debt security at the impairment measurement date is recorded in "Other comprehensive income (loss)." Unrealized gains or losses on securities for which an other-than-temporary impairment has been recognized in earnings is tracked as a separate component of "Accumulated other comprehensive income (loss)." Prior to the adoption of this guidance in 2009, an other-than-temporary impairment recognized in earnings for debt securities was equal to the total difference between amortized cost and fair value at the time of impairment.

For debt securities, the split between the amount of an other-than-temporary impairment recognized in other comprehensive income and the net amount recognized in earnings is driven principally by assumptions regarding the amount and timing of projected cash flows. For mortgage-backed and asset-backed securities, cash flow estimates consider the payment terms of the underlying assets backing a particular security, including prepayment assumptions, and are based on data from widely accepted third-party data sources or internal estimates. In addition to prepayment assumptions, cash flow estimates include assumptions regarding the underlying collateral including default rates and recoveries which vary based on the asset type and geographic location, as well as the vintage year of the security. For structured securities, the payment priority within the tranche structure is also considered. For all other debt securities, cash flow estimates are driven by assumptions regarding probability of default and estimates regarding timing and amount of recoveries associated with a default. The Company has developed these estimates using information based on its historical experience as well as using market observable data, such as industry analyst reports and forecasts, sector credit ratings and other data relevant to the collectability of a security, such as the general payment terms of the security and the security's position within the capital structure of the issuer.

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

#### *Cash and Cash Equivalents*

Cash and cash equivalents include cash on hand, amounts due from banks, certain money market investments, and other debt issues with maturities of three months or less when purchased. The Company also engages in overnight borrowing and lending of funds with Prudential Financial and affiliates which are considered cash and cash equivalents.

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

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### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### *Deferred Policy Acquisition Costs*

Costs that vary with and that are related primarily to the production of new insurance and annuity products are deferred to the extent such costs are deemed recoverable from future profits. Such deferred policy acquisition costs (“DAC”) include commissions, costs of policy issuance and underwriting, and variable field office expenses that are incurred in producing new business. In each reporting period, capitalized DAC is amortized. DAC is subject to recoverability testing at the end of each reporting period to ensure that the capitalized amounts do not exceed the present value of anticipated gross profits or premiums less benefits and maintenance expenses, as applicable. DAC, for applicable products, is adjusted for the impact of unrealized gains or losses on investments as if these gains or losses had been realized, with corresponding credits or charges included in “Accumulated other comprehensive income (loss).”

Policy acquisition costs are deferred and amortized over the expected life of the contracts (approximately 25 – 99 years) in proportion to gross profits arising principally from investment results, mortality and expense margins, and surrender charges, based on historical and anticipated future experience, which is updated periodically. The Company uses a reversion to the mean approach to derive the future rate of return assumptions. However, if the projected future rate of return calculated using this approach is greater than the maximum future rate of return assumption, the maximum future rate of return is utilized. In addition to the gross profit components previously mentioned, we also include the impact of the embedded derivatives associated with certain optional living benefit features of the Company’s variable annuity contracts and related hedging activities in actual gross profits used as the basis for calculating current period amortization, regardless of which affiliated legal entity this activity occurs. In calculating gross profits, profits and losses related to contracts issued by the Company that are reported in affiliated legal entities other than the Company as a result of, for example, reinsurance agreements with those affiliated entities are also included. The Company is an indirect subsidiary of Prudential Financial (an SEC registrant) and has extensive transactions and relationships with other subsidiaries of Prudential Financial, including reinsurance agreements. See Note 13 in the Financial Statements. Incorporating all product-related profits and losses in gross profits, including those that are reported in affiliated legal entities, produces a DAC amortization pattern representative of the economics of the products. The effect of changes to estimated gross profits on unamortized deferred acquisition costs is reflected in “Amortization of deferred policy acquisition costs” in the period such estimated gross profits are revised.

For some products, policyholders can elect to modify product benefits, features, rights or coverages by exchanging a contract for a new contract or by amendment, endorsement, or rider to a contract, or by the election of a feature or coverage within a contract. These transactions are known as internal replacements. If policyholders surrender traditional life insurance policies in exchange for life insurance policies that do not have fixed and guaranteed terms, the Company immediately charges to expense the remaining unamortized DAC on the surrendered policies. For other internal replacement transactions, except those that involve the addition of a non-integrated contract feature that does not change the existing base contract, the unamortized DAC is immediately charged to expense if the terms of the new policies are not substantially similar to those of the former policies. If the new terms are substantially similar to those of the earlier policies, the DAC is retained with respect to the new policies and amortized over the expected life of the new policies.

#### *Reinsurance Recoverables*

Reinsurance recoverables include corresponding payables and receivables associated with reinsurance arrangements with affiliates. For additional information about these arrangements see Note 13 to the Financial Statements.

# **Pruco Life Insurance Company of New Jersey**

## **Notes to Financial Statements**

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### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

#### ***Separate Account Assets and Liabilities***

Separate account assets are reported at fair value and represent segregated funds, which are invested for certain policyholders and other customers. The assets consist primarily of equity securities, fixed maturities, real estate related investments, real estate mortgage loans and short term investments and derivative instruments. The assets of each account are legally segregated and are generally not subject to claims that arise out of any other business of the Company. Investment risks associated with market value changes are borne by the customers, except to the extent of minimum guarantees made by the Company with respect to certain accounts. Separate account liabilities primarily represent the contractholder's account balance in separate account assets and to a lesser extent borrowings of the separate account. See Note 7 to the Financial Statements for additional information regarding separate account arrangements with contractual guarantees. The investment income and realized investment gains or losses from separate accounts generally accrue to the policyholders and are not included in the Statements of Operations. Mortality, policy administration and surrender charges assessed against the accounts are included in "Policy charges and fee income." Asset administration fees charged to the accounts are included in "Asset administration fees."

#### ***Deferred Sales Inducements***

The Company provides sales inducements to contractholders, which primarily reflect an up-front bonus added to the contractholder's initial deposit for certain annuity contracts. These costs are deferred and recognized in "Deferred sales inducements". They are amortized using the same methodology and assumptions used to amortize DAC. Sales inducements balances are subject to recoverability testing at the end of each reporting period to ensure that the capitalized amounts do not exceed the present value of anticipated gross profits. The Company records amortization of deferred sales inducements in "Interest credited to policyholders' account balances."

#### ***Other Assets and Other Liabilities***

Other assets consist primarily of premiums due, certain restricted assets, and receivables resulting from sales of securities that had not yet settled at the balance sheet date. Other liabilities consist primarily of accrued expenses, technical overdrafts, derivatives, and payables resulting from purchases of securities that had not yet been settled at the balance sheet date.

#### ***Future Policy Benefits***

The Company's liability for future policy benefits is primarily comprised of the present value of estimated future payments to or on behalf of policyholders, where the timing and amount of payment depends on policyholder mortality or morbidity, less the present value of future net premiums. For life insurance and annuity products, expected mortality and morbidity is generally based on the Company's historical experience or standard industry tables including a provision for the risk of adverse deviation on our term life products. Interest rate assumptions are based on factors such as market conditions and expected investment returns. Although mortality and morbidity and interest rate assumptions are "locked-in" upon the issuance of new insurance or annuity products with fixed and guaranteed terms, significant changes in experience or assumptions may require the Company to provide for expected future losses on a product by establishing premium deficiency reserves. Premium deficiency reserves, if required, are determined based on assumptions at the time the premium deficiency reserve is established and do not include a provision for the risk of adverse deviation. The Company's liability for future policy benefits also includes net liabilities for guarantee benefits related to certain nontraditional long-duration life and annuity contracts, which are discussed more fully in Note 7, and certain unearned revenues.

# **Pruco Life Insurance Company of New Jersey**

## **Notes to Financial Statements**

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### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

#### ***Policyholders' Account Balances***

The Company's liability for policyholders' account balances represents the contract value that has accrued to the benefit of the policyholder as of the balance sheet date. This liability is generally equal to the accumulated account deposits, plus interest credited, less policyholders' withdrawals and other charges assessed against the account balance. These policyholders' account balances also include a provision for benefits under non-life contingent payout annuities and certain unearned revenues.

#### ***Contingent Liabilities***

Amounts related to contingent liabilities are accrued if it is probable that a liability has been incurred and an amount is reasonably estimable. Management evaluates whether there are incremental legal or other costs directly associated with the ultimate resolution of the matter that are reasonably estimable and, if so, they are included in the accrual.

#### ***Insurance Revenue and Expense Recognition***

Premiums from individual life products, other than interest-sensitive life contracts, are recognized when due. When premiums are due over a significantly shorter period than the period over which benefits are provided, any gross premium in excess of the net premium (i.e., the portion of the gross premium required to provide for all expected future benefits and expenses) is deferred and recognized into revenue in a constant relationship to insurance in force. Benefits are recorded as an expense when they are incurred. A liability for future policy benefits is recorded when premiums are recognized using the net premium method.

Certain individual annuity contracts provide the holder a guarantee that the benefit received upon death or annuitization will be no less than a minimum prescribed amount. These benefits are accounted for as insurance contracts and are discussed in further detail in Note 7. The Company also provides contracts with certain living benefits which are accounted for as embedded derivatives. These contracts are discussed in further detail in Note 7.

Amounts received as payment for interest-sensitive contracts, are reported as deposits to "Policyholders' account balances." Revenues from these contracts are reflected in "Policy charges and fee income" consisting primarily of fees assessed during the period against the policyholders' account balances for mortality charges, policy administration charges and surrender charges. In addition to fees, the Company earns investment income from the investment of policyholders' deposits in the Company's general account portfolio. Fees assessed that represent compensation to the Company for services to be provided in future periods and certain other fees are deferred and amortized into revenue over the life of the related contracts in proportion to estimated gross profits. Benefits and expenses for these products include claims in excess of related account balances, expenses of contract administration, interest credited to policyholders' account balances and amortization of DAC. Premiums, benefits and expenses are stated net of reinsurance ceded to other companies. Estimated reinsurance recoverables and the cost of reinsurance are recognized over the life of the reinsured policies using assumptions consistent with those used to account for the underlying policies.

#### ***Asset Administration Fees***

The Company receives asset administration fee income from policyholders' account balances invested in The Prudential Series Funds or, "PSF," which are a portfolio of mutual fund investments related to the Company's separate account products. Also the Company receives fee income calculated on contractholder separate account balances invested in the Advanced Series Trust Funds (see Note 13 to the Financial Statements). In addition, the Company receives fees from policyholders' account balances invested in funds managed by companies other than Prudential Insurance. Asset administration fees are recognized as income when earned.

# **Pruco Life Insurance Company of New Jersey**

## **Notes to Financial Statements**

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### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

#### ***Derivative Financial Instruments***

Derivatives are financial instruments whose values are derived from interest rates, financial indices, or the values of securities. Derivative financial instruments generally used by the Company include swaps, futures, forwards and options which are contracted in the over-the-counter market with an affiliate. Derivative positions are carried at fair value, generally by obtaining quoted market prices or through the use of valuation models. Values can be affected by changes in interest rates, financial indices, values of securities, credit spreads, market volatility, expected returns and liquidity. Values can also be affected by changes in estimates and assumptions, including those related to counterparty behavior and non performance risk, used in valuation models.

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

Derivatives are recorded either as assets, within "Other long-term investments," or as liabilities, within "Other liabilities," except for embedded derivatives, which are recorded with the associated host contract. The Company nets the fair value of all derivative financial instruments with its affiliated counterparty for which a master netting arrangement has been executed. As discussed below and in Note 11, all realized and unrealized changes in fair value of derivatives, with the exception of the effective portion of cash flow hedges are recorded in current earnings. Cash flows from these derivatives are reported in the operating and investing activities sections in the Statements of Cash Flows.

The Company designates derivatives as either (1) a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow" hedge), or (2) a derivative that does not qualify for hedge accounting.

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

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

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

If it is determined that a derivative no longer qualifies as an effective cash flow hedge, or management removes the hedge designation, the derivative will continue to be carried on the balance sheet at its fair value, with changes in fair value recognized currently in "Realized investment gains (losses), net." The asset or liability

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

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### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

under a fair value hedge will no longer be adjusted for changes in fair value and the existing basis adjustment is amortized to the income statement line associated with the asset or liability. The component of “Accumulated other comprehensive income (loss)” related to discontinued cash flow hedges is amortized to the income statement line associated with the hedged cash flows consistent with the earnings impact of the original hedged cash flows.

When hedge accounting is discontinued because it is probable that the forecasted transaction will not occur by the end of the specified time period, the derivative will continue to be carried on the balance sheet at its fair value, with changes in fair value recognized currently in “Realized investment gains (losses), net.” Gains and losses that were in “Accumulated other comprehensive income (loss)” pursuant to the hedge of a forecasted transaction are recognized immediately in “Realized investment gains (losses), net.”

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

#### *Income Taxes*

The Company is a member of the consolidated federal income tax return of Prudential Financial and primarily files separate company state and local tax returns. Pursuant to the tax allocation arrangement with Prudential Financial, total federal income tax expense is determined on a separate company basis. Members with losses record tax benefits to the extent such losses are recognized in the consolidated federal tax provision.

Deferred income taxes are recognized, based on enacted rates, when assets and liabilities have different values for financial statement and tax reporting purposes. A valuation allowance is recorded to reduce a deferred tax asset to the amount expected to be realized.

The Company’s liability for income taxes includes the liability for unrecognized tax benefits and interest and penalties which relate to tax years still subject to review by the Internal Revenue Service (“IRS”) or other taxing jurisdictions. Audit periods remain open for review until the statute of limitations has passed. Generally, for tax years which produce net operating losses, capital losses or tax credit carryforwards (“tax attributes”), the statute of limitations does not close, to the extent of these tax attributes, until the expiration of the statute of limitations for the tax year in which they are fully utilized. The completion of review or the expiration of the statute of limitations for a given audit period could result in an adjustment to the liability for income taxes. The Company classifies all interest and penalties related to tax uncertainties as income tax expense. See Note 9 for additional information regarding income taxes.

#### *Adoption of New Accounting Pronouncements*

In July 2010, the FASB issued updated guidance that requires enhanced disclosures related to the allowance for credit losses and the credit quality of a company’s financing receivable portfolio. The disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The Company adopted this guidance effective December 31, 2010. The required disclosures are included above and in Note 3. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning after December 15, 2010. The Company will provide these required disclosures in the interim reporting period ended March 31, 2011. In January 2011, the FASB deferred the disclosures required by this guidance related to troubled debt restructurings. The disclosures will be effective, and the Company will provide these disclosures, concurrent with the effective date of proposed guidance for determining what constitutes a troubled debt restructuring.

# **Pruco Life Insurance Company of New Jersey**

## **Notes to Financial Statements**

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### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

In March 2010, the FASB issued updated guidance that amends and clarifies the accounting for credit derivatives embedded in interests in securitized financial assets. This new guidance eliminates the scope exception for embedded credit derivatives (except for those that are created solely by subordination) and provides new guidance on how the evaluation of embedded credit derivatives is to be performed. This new guidance is effective for the first interim reporting period beginning after June 15, 2010. The Company's adoption of this guidance effective with the interim reporting period ending September 30, 2010 did not have a material effect on the Company's financial position, results of operations, and financial statement disclosures.

In January 2010, the FASB issued updated guidance that requires new fair value disclosures about significant transfers between Level 1 and 2 measurement categories and separate presentation of purchases, sales, issuances, and settlements within the roll forward of Level 3 activity. Also, this updated fair value guidance clarifies the disclosure requirements about level of disaggregation and valuation techniques and inputs. This new guidance is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of Level 3 activity, which are effective for interim and annual reporting periods beginning after December 15, 2010. The Company adopted the effective portions of this guidance on January 1, 2010. The required disclosures are provided in Note 10 and Note 11. The Company will provide the required disclosures about purchases, sales, issuances, and settlements in the roll forward of Level 3 activity in the interim reporting period ending March 31, 2011.

In September 2009, the FASB issued updated guidance for the fair value measurement of investments in certain entities that calculate net asset value per share including certain alternative investments such as hedge funds, private equity funds, and venture capital funds. This guidance allows companies to determine the fair value of such investments using net asset value ("NAV") as a practical expedient if the fair value of the investment is not readily determinable and the investee entity issues financial statements in accordance with measurement principles for investment companies. Use of this practical expedient is prohibited if it is probable the investment will be sold at something other than NAV. This guidance also requires new disclosures for each major category of alternative investments. It was effective for the first annual or interim reporting period ending after December 15, 2009. The Company's adoption of this guidance effective December 31, 2009 did not have a material effect on the Company's financial position, results of operations and financial statement disclosures.

In August 2009, the FASB issued updated guidance for the fair value measurement of liabilities. This guidance provides clarification on how to measure fair value in circumstances in when a quoted price in an active market for the identical liability is not available. This guidance also clarifies that restrictions preventing the transfer of a liability should not be considered as a separate input or adjustment in the measurement of fair value. The Company adopted this guidance effective with the annual reporting period ended December 31, 2009, and the adoption did not have a material impact on the Company's financial position, results of operations, and financial statement disclosures.

In June 2009, the FASB issued authoritative guidance for the FASB's Accounting Standards Codification TM as the source of authoritative U.S. GAAP. The Codification is not intended to change U.S. GAAP but is a new structure which organizes accounting pronouncements by accounting topic. This guidance is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Company's adoption of this guidance effective with the interim reporting period ending September 30, 2009 impacted the way the Company references U.S. GAAP accounting standards in the financial statements.

In April 2009, the FASB revised the authoritative guidance for disclosures about fair value of financial instruments. This new guidance requires disclosures about fair value of financial instruments for interim

# **Pruco Life Insurance Company of New Jersey**

## **Notes to Financial Statements**

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### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

reporting periods similar to those included in annual financial statements. This guidance is effective for interim reporting periods ending after June 15, 2009. The Company adopted this guidance effective with the interim period ending June 30, 2009.

In April 2009, the FASB revised the authoritative guidance for the recognition and presentation of other-than-temporary impairments. This new guidance amends the other-than-temporary impairment guidance for debt securities and expands the presentation and disclosure requirements of other-than-temporary impairments on debt and equity securities in the financial statements. This guidance also requires that the required annual disclosures for debt and equity securities be made for interim reporting periods. This guidance does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. This guidance is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Company early adopted this guidance effective January 1, 2009, which resulted in a net after-tax increase to retained earnings and decrease to accumulated other comprehensive income (loss) of \$19.6 million. The disclosures required by this new guidance are provided in Note 3. See “Investments and Investment-Related Liabilities” above for more information.

In April 2009, the FASB revised the authoritative guidance for fair value measurements and disclosures to provide guidance on (1) estimating the fair value of an asset or liability if there was a significant decrease in the volume and level of trading activity for these assets or liabilities, and (2) identifying transactions that are not orderly. Further, this new guidance requires additional disclosures about fair value measurements in interim and annual periods. This guidance is effective for interim and annual reporting periods ending after June 15, 2009, and shall be applied prospectively. Early adoption is permitted for periods ending after March 15, 2009. The Company’s early adoption of this guidance effective January 1, 2009 did not have a material effect on the Company’s financial position or results of operations. The disclosures required by this revised guidance are provided in Note 10.

In October 2008, the FASB revised the authoritative guidance on determining the fair value of a financial asset when the market for that asset is not active. This guidance clarifies the application of fair value measurements in a market that is not active and applies to financial assets within the scope of accounting pronouncements that require or permit fair value measurements. The guidance was effective upon issuance, including prior periods for which financial statements had not been issued. The Company’s adoption of this guidance effective September 30, 2008 did not have a material effect on the Company’s financial position or results of operations.

In March 2008, the FASB issued authoritative guidance for derivative instruments and hedging activities which amends and expands the disclosure requirements for derivative instruments and hedging activities by requiring companies to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for, and (c) how derivative instruments and related hedged items affect an entity’s financial position, financial performance, and cash flows. The Company’s adoption of this guidance effective January 1, 2009 did not have a material effect on the Company’s financial position or results of operations. The required disclosures are provided in Note 11.

In February 2008, the FASB revised the authoritative guidance for the accounting for transfers of financial assets and repurchase financing transactions. The new guidance provides recognition and derecognition guidance for a repurchase financing transaction, which is a repurchase agreement that relates to a previously transferred financial asset between the same counterparties that is entered into contemporaneously with or in contemplation of, the initial transfer. The guidance is effective for fiscal years beginning after November 15, 2008. The Company’s adoption of this guidance on a prospective basis effective January 1, 2009 did not have a material effect on the Company’s financial position or results of operations.

# **Pruco Life Insurance Company of New Jersey**

## **Notes to Financial Statements**

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### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

In February 2008, the FASB revised the authoritative guidance which delays the effective date of the authoritative guidance related to fair value measurements and disclosures for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The Company's adoption of this guidance effective January 1, 2009 did not have a material effect on the Company's financial position or results of operations.

In January 2008, the FASB issued authoritative guidance for application of the shortcut method to hedge accounting with respect to the conditions that must be met to apply the shortcut method for assessing hedge effectiveness. This new guidance was effective for hedging relationships designated on or after January 1, 2008. The Company's adoption of this guidance effective January 1, 2008 did not have a material effect on the Company's financial position or results of operations.

In February 2007, the FASB issued authoritative guidance on the fair value option for financial assets and financial liabilities. This guidance provides companies with an option to report selected financial assets and liabilities at fair value, with the associated changes in fair value reflected in the Statements of Operations. The Company adopted this guidance effective January 1, 2008.

In September 2006, the FASB issued authoritative guidance on fair value measurements. This guidance defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. This guidance does not change which assets and liabilities are required to be recorded at fair value, but the application of this guidance could change practices in determining fair value. The Company adopted this guidance effective January 1, 2008. See Note 10 for more information on fair value measurements guidance.

#### ***Future Adoption of New Accounting Pronouncements***

In October 2010, the FASB issued guidance to address diversity in practice regarding the interpretation of which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral. Under the new guidance acquisition costs are to include only those costs that are directly related to the acquisition or renewal of insurance contracts by applying a model similar to the accounting for loan origination costs. An entity may defer incremental direct costs of contract acquisition that are incurred in transactions with independent third parties or employees as well as the portion of employee compensation costs related to underwriting, policy issuance and processing, medical inspection, and contract selling for successfully negotiated contracts. Additionally, an entity may capitalize as a deferred acquisition cost only those advertising costs meeting the capitalization criteria for direct-response advertising. This change is effective for fiscal years beginning after December 15, 2011 and interim periods within those years. Early adoption as of the beginning of a fiscal year is permitted. The guidance is to be applied prospectively upon the date of adoption, with retrospective application permitted, but not required. The Company will adopt this guidance effective January 1, 2012. The Company is currently assessing the impact of the guidance on the Company's financial position, results of operations, and financial statement disclosures.

In April 2010, the FASB issued guidance clarifying that an insurance entity should not consider any separate account interests in an investment held for the benefit of policyholders to be the insurer's interests, and should not combine those interests with its general account interest in the same investment when assessing the investment for consolidation, unless the separate account interests are held for a related party policyholder, whereby consolidation of such interests must be considered under applicable variable interest guidance. This guidance is effective for interim and annual periods beginning after December 15, 2010 and retrospectively to all

## Pruco Life Insurance Company of New Jersey

### Notes to Financial Statements

#### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

prior periods upon the date of adoption, with early adoption permitted. The Company's adoption of this guidance effective January 1, 2011 is not expected to have a material effect on the Company's financial position, results of operations, and financial statement disclosures.

#### 3. INVESTMENTS

##### *Fixed Maturities and Equity Securities*

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

	December 31, 2010				
	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Other-than- temporary impairments in AOCI(3)</u>
	(in thousands)				
<b>Fixed maturities, available for sale</b>					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$ 34,292	\$ 2,199	\$ 41	\$ 36,450	\$ -
Obligations of U.S. states and their political subdivisions	-	-	-	-	-
Foreign government bonds	21,034	1,644	-	22,678	-
Corporate securities	707,754	47,472	2,945	752,281	(26)
Asset-backed securities(1)	57,808	1,671	5,446	54,033	(8,856)
Commercial mortgage-backed securities	97,467	5,721	87	103,101	-
Residential mortgage-backed securities(2)	89,300	6,746	48	95,998	(454)
Total fixed maturities, available for sale	<u>\$1,007,655</u>	<u>\$65,453</u>	<u>\$8,567</u>	<u>\$1,064,541</u>	<u>\$(9,336)</u>
Equity securities, available for sale	<u>\$ 2,301</u>	<u>\$ 178</u>	<u>\$ 405</u>	<u>\$ 2,074</u>	

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

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

(3) Represents the amount of other-than-temporary impairment losses in "Accumulated other comprehensive income (loss)," or "AOCI," which, from January 1, 2009, were not included in earnings under new authoritative accounting guidance. Amount excludes \$5 million of net unrealized gains (losses) on impaired securities relating to changes in the fair value of such securities subsequent to the impairment measurement date.

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

### 3. INVESTMENTS (continued)

	December 31, 2009				
	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Other-than- temporary impairments in AOCI(3)</u>
	(in thousands)				
<b>Fixed maturities, available for sale</b>					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$ 69,978	\$ 809	\$ 268	\$ 70,519	-
Obligations of U.S. states and their political subdivisions	-	-	-	-	-
Foreign government bonds	22,188	1,232	272	23,148	-
Corporate securities	667,718	27,475	5,101	690,092	(681)
Asset-backed securities(1)	62,273	1,132	6,560	56,845	(9,940)
Commercial mortgage-backed securities	91,971	2,220	725	93,466	-
Residential mortgage-backed securities(2)	114,258	6,465	413	120,310	(626)
Total fixed maturities, available for sale	<u>\$1,028,386</u>	<u>\$39,333</u>	<u>\$13,339</u>	<u>\$1,054,380</u>	<u>\$(11,247)</u>
Equity securities, available for sale	<u>\$ 4,003</u>	<u>\$ 129</u>	<u>\$ 306</u>	<u>\$ 3,826</u>	

- (1) Includes credit tranching securities collateralized by sub-prime mortgages, auto loans, credit cards, education loans, and other asset types.
- (2) Includes publicly traded agency pass-through securities and collateralized mortgage obligations.
- (3) Represents the amount of other-than-temporary impairment losses in "Accumulated other comprehensive income (loss)," or "AOCI," which, from January 1, 2009, were not included in earnings under new authoritative accounting guidance. Amount excludes \$5 million of net unrealized gains (losses) on impaired securities relating to changes in the fair value of such securities subsequent to the impairment measurement date.

The amortized cost and fair value of fixed maturities by contractual maturities at December 31, 2010, are as follows:

	Available for Sale	
	<u>Amortized Cost</u>	<u>Fair Value</u>
	(in thousands)	
Due in one year or less	\$ 44,597	\$ 45,431
Due after one year through five years	302,516	323,819
Due after five years through ten years	326,528	348,498
Due after ten years	89,439	93,660
Asset-backed securities	57,808	54,034
Commercial mortgage-backed securities	97,467	103,101
Residential mortgage-backed securities	89,300	95,998
Total	<u>\$ 1,007,655</u>	<u>\$ 1,064,541</u>

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

### 3. INVESTMENTS (continued)

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

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

	<u>2010</u>	<u>2009</u>	<u>2008</u>
	(in thousands)		
<b>Fixed maturities, available for sale:</b>			
Proceeds from sales	\$ 35,017	\$ 59,587	\$206,732
Proceeds from maturities/repayments	157,785	194,623	42,743
Gross investment gains from sales, prepayments and maturities	4,160	1,540	1,108
Gross investment losses from sales and maturities	(83)	(3,027)	(2,539)
<b>Fixed maturity and equity security impairments:</b>			
Net writedowns for other-than-temporary impairment losses on fixed maturities recognized in earnings(1)	\$ (2,554)	\$ (6,070)	\$ (9,149)
Writedowns for other-than-temporary impairment losses on equity securities	\$ -	\$ (139)	\$ -

- (1) Effective with the adoption of new authoritative guidance January 1, 2009, excludes the portion of other-than-temporary impairments recorded in "Other comprehensive income (loss)," representing any difference between the fair value of the impaired debt security and the net present value of its projected future cash flows at the time of impairment.

As discussed in Note 2, a portion of certain other-than-temporary impairment ("OTTI") losses on fixed maturity securities are recognized in "Other comprehensive income (loss)" ("OCI"). The net amount recognized in earnings ("credit loss impairments") represents the difference between the amortized cost of the security and the net present value of its projected future cash flows discounted at the effective interest rate implicit in the debt security prior to impairment. Any remaining difference between the fair value and amortized cost is recognized in OCI. The following tables set forth the amount of pre-tax credit loss impairments on fixed maturity securities held by the Company as of the dates indicated, for which a portion of the OTTI loss was recognized in OCI, and the corresponding changes in such amounts for the periods indicated.

	<u>Year Ended December 31, 2010</u>
	(in thousands)
<b>Credit losses recognized in earnings on fixed maturity securities held by the Company for which a portion of the OTTI loss was recognized in OCI</b>	
Balance, beginning of period, January 1, 2009	\$ -
Credit losses remaining in retained earnings related to adoption of new authoritative guidance on January 1, 2009	2,361
Credit loss impairments previously recognized on securities which matured, paid down, prepaid or were sold during the period	(603)
Credit loss impairments previously recognized on securities impaired to fair value during the period (1)	-
Credit loss impairment recognized in the current period on securities not previously impaired	2,557
Additional credit loss impairments recognized in the current period on securities previously impaired	2,563
Increases due to the passage of time on previously recorded credit losses	546
Accretion of credit loss impairments previously recognized due to an increase in cash flows expected to be collected	7
Balance, December 31, 2009	<u>\$7,431</u>

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

### 3. INVESTMENTS (continued)

	<b>Year Ended December 31, 2010</b>
	(in thousands)
Balance, beginning of period, January 1, 2010	\$ 7,431
Credit loss impairments previously recognized on securities which matured, paid down, prepaid or were sold during the period	(1,059)
Credit loss impairments previously recognized on securities impaired to fair value during the period (1)	(992)
Credit loss impairment recognized in the current period on securities not previously impaired	-
Additional credit loss impairments recognized in the current period on securities previously impaired	1,965
Increases due to the passage of time on previously recorded credit losses	530
Accretion of credit loss impairments previously recognized due to an increase in cash flows expected to be collected	(1,112)
Balance, December 31, 2010	<u>\$ 6,763</u>

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

### *Commercial Mortgage Loans*

The Company's commercial mortgage loans are comprised as follows at December 31:

	<u>2010</u>		<u>2009</u>	
	<u>Amount (in thousands)</u>	<u>% of Total</u>	<u>Amount (in thousands)</u>	<u>% of Total</u>
<b>Commercial mortgage loans by property type:</b>				
Industrial buildings	\$ 35,745	19.4%	\$ 36,102	21.2%
Retail stores	36,046	19.6%	36,941	21.7%
Apartments/Multi-family	25,340	13.8%	15,886	9.3%
Office buildings	30,468	16.6%	19,179	11.3%
Hospitality	10,273	5.6%	10,399	6.1%
Other	33,834	18.4%	34,902	20.4%
Total collateralized loans	<u>\$171,706</u>	<u>93.4%</u>	<u>\$153,409</u>	<u>90.0%</u>
Agricultural property loans	<u>12,140</u>	<u>6.6%</u>	<u>16,905</u>	<u>10.0%</u>
Total commercial mortgage and agricultural loans	<u>\$183,846</u>	<u>100.0%</u>	<u>\$170,314</u>	<u>100.0%</u>
Valuation allowance	(1,409)		(2,379)	
Total net commercial mortgage loans	<u>\$182,437</u>		<u>\$167,935</u>	

The commercial loans are geographically dispersed throughout the United States with the largest concentrations in New Jersey (12%) and Florida (11%) at December 31, 2010.

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

### 3. INVESTMENTS (continued)

Activity in the allowance for losses for all commercial loans, for the years ended December 31, is as follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
	(in thousands)		
Allowance for losses, beginning of year	\$2,379	\$1,444	\$ 560
Increase/(Decrease) to allowance for losses	(970)	935	884
Allowance for losses, end of year	<u>\$1,409</u>	<u>\$2,379</u>	<u>\$1,444</u>

The following table sets forth the allowance for credit losses and the recorded investment in commercial mortgage and other loans as of December 31, 2010:

	<u>Commercial Mortgage Loans</u>	<u>Agricultural Property Loans</u>	<u>Total</u>
	(in thousands)		
<b>Allowance for Credit Losses:</b>			
Ending Balance: individually evaluated for impairment	\$ 424	\$ -	\$ 424
Ending Balance: collectively evaluated for impairment	964	21	985
Total Ending Balance	<u>\$ 1,388</u>	<u>\$ 21</u>	<u>\$ 1,409</u>
<b>Recorded Investment:</b>			
Ending balance gross of reserves: individually evaluated for impairment	\$ 3,847	\$ -	\$ 3,847
Ending balance gross of reserves: collectively evaluated for impairment	167,859	12,140	179,999
Total Ending balance, gross of reserves	<u>\$171,706</u>	<u>\$12,140</u>	<u>\$183,846</u>

Impaired loans include those loans for which it is probable that amounts due according to the contractual terms of the loan agreement will not all be collected.

At December 31, 2010 impaired commercial mortgage loans identified in management's specific review of probable loan losses consisted of Hospitality commercial mortgage loans with a recorded investment of \$3.8 million, an unpaid principal balance of \$3.8 million and the related allowance for losses was \$0.4 million. Recorded investment reflects the balance sheet carrying value gross of related allowance.

Non-performing commercial mortgage and other loans with no allowance for losses are loans in which the fair value of the collateral or the net present value of the loans' expected future cash flows equals or exceeds the recorded investment. The average recorded investment in non-performing loans before allowance for losses was \$3.9 million and \$2.2 million for the years ended December 31, 2010 and December 31, 2009, respectively. Net investment income recognized on these loans totaled less than \$0.3 million for the years ended December 31, 2010 and December 31, 2009, respectively. See Note 2 for information regarding the Company's accounting policies for non-performing loans.

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

### 3. INVESTMENTS (continued)

The following tables set forth the credit quality indicators as of December 31, 2010:

#### Commercial mortgage loans

	Debt Service Coverage Ratio						Grand Total
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X	1.0X to <1.2X	Less than 1.0X	
<b>Loan-to-Value Ratio</b>	(in thousands)						
0%-49.99%	\$21,321	\$13,638	\$12,741	\$ -	\$ 4,346	\$ -	\$ 52,046
50%-59.99%	-	11,267	-	-	3,647	-	14,914
60%-69.99%	5,000	14,954	-	1,784	9,758	-	31,496
70%-79.99%	5,000	9,463	-	29,377	9,105	2,365	55,310
80%-89.99%	-	-	-	12,409	-	-	12,409
90%-100%	-	-	-	-	-	1,684	1,684
Greater than 100%	-	-	-	3,847	-	-	3,847
Total Commercial Mortgage Loans	<u>\$31,321</u>	<u>\$49,322</u>	<u>\$12,741</u>	<u>\$47,417</u>	<u>\$26,856</u>	<u>\$4,049</u>	<u>\$171,706</u>

#### Agricultural loans

	Debt Service Coverage Ratio						Grand Total
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X	1.0X to <1.2X	Less than 1.0X	
<b>Loan-to-Value Ratio</b>	(in thousands)						
0%-49.99%	\$3,016	\$960	\$4,009	\$2,462	\$-	\$-	\$10,447
50%-59.99%	-	-	-	-	-	-	-
60%-69.99%	1,693	-	-	-	-	-	1,693
70%-79.99%	-	-	-	-	-	-	-
80%-89.99%	-	-	-	-	-	-	-
90%-100%	-	-	-	-	-	-	-
Greater than 100%	-	-	-	-	-	-	-
Total Agricultural Loans	<u>\$4,709</u>	<u>\$960</u>	<u>\$4,009</u>	<u>\$2,462</u>	<u>\$-</u>	<u>\$-</u>	<u>\$12,140</u>

#### Commercial mortgage and Agricultural loans

	Debt Service Coverage Ratio						Grand Total
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X	1.0X to <1.2X	Less than 1.0X	
<b>Loan-to-Value Ratio</b>	(in thousands)						
0%-49.99%	\$24,337	\$14,598	\$16,750	\$ 2,462	\$ 4,346	\$ -	\$ 62,493
50%-59.99%	-	11,267	-	-	3,647	-	14,914
60%-69.99%	6,693	14,954	-	1,784	9,758	-	33,189
70%-79.99%	5,000	9,463	-	29,377	9,105	2,365	55,310
80%-89.99%	-	-	-	12,409	-	-	12,409
90%-100%	-	-	-	-	-	1,684	1,684
Greater than 100%	-	-	-	3,847	-	-	3,847
Total Commercial Mortgage and Agricultural Loans	<u>\$36,030</u>	<u>\$50,282</u>	<u>\$16,750</u>	<u>\$49,879</u>	<u>\$26,856</u>	<u>\$4,049</u>	<u>\$183,846</u>

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

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### 3. INVESTMENTS (continued)

All commercial mortgage and agricultural property loans are current as of December 31, 2010. The Company defines current in its aging of past due commercial mortgage and agricultural loans as less than 30 days past due.

Commercial mortgage and other loans on nonaccrual status as of December 31, 2010 include Hospitality commercial mortgage loans with a gross carrying value of \$3.8 million. See Note 2 for further discussion regarding loans on nonaccrual status.

#### *Other Long term Investments*

“Other long-term investments” are comprised as follows at December 31:

	<u>2010</u>	<u>2009</u>
	(in thousands)	
Company’s investment in Separate accounts	\$ 1,893	\$2,213
Joint ventures and limited partnerships	15,020	6,096
Derivatives(1)	-	-
Total other long-term investments	<u>\$16,913</u>	<u>\$8,309</u>

- (1) Derivative balances of (\$0.9) million and (\$3.5) million at December 31, 2010 and 2009, respectively, were reclassified to Other Liabilities.

#### *Net Investment Income*

Net investment income for the years ended December 31, was from the following sources:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
	(in thousands)		
Fixed maturities, available for sale	\$57,502	\$53,615	\$52,035
Equity securities, available for sale	148	218	263
Commercial mortgage loans	11,264	9,822	8,216
Policy loans	9,363	9,177	9,187
Short-term investments and cash equivalents	129	434	1,455
Other long-term investments	1,691	(666)	(2)
Gross investment income	<u>80,097</u>	<u>72,600</u>	<u>71,154</u>
Less investment expenses	<u>(3,053)</u>	<u>(2,656)</u>	<u>(3,153)</u>
Net investment income	<u>\$77,044</u>	<u>\$69,944</u>	<u>\$68,001</u>

Carrying value for non-income producing assets included in fixed maturities totaled \$0 million and \$2 million as of December 31, 2010 and December 31, 2009, respectively. Non-income producing assets represent investments that have not produced income for the twelve months preceding December 31, 2010.

## Pruco Life Insurance Company of New Jersey

### Notes to Financial Statements

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#### 3. INVESTMENTS (continued)

##### *Realized Investment Gains (Losses), Net*

Realized investment gains (losses), net, for the years ended December 31, were from the following sources:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
		(in thousands)	
Fixed maturities	1,523	(7,557)	(10,575)
Equity securities	139	(138)	-
Commercial mortgage loans	970	(935)	(884)
Short-term investments and cash equivalents	5	-	-
Joint ventures and limited partnerships	-	(124)	-
Derivatives	54,378	22,268	(15,496)
Realized investment gains/(losses), net	<u>\$57,015</u>	<u>\$13,514</u>	<u>\$(26,955)</u>

##### *Net Unrealized Investment Gains (Losses)*

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

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

### 3. INVESTMENTS (continued)

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

	<u>Net Unrealized Gains (Losses) On Investments</u>	<u>Deferred Policy Acquisition Costs and Other Costs</u>	<u>Policy Holders Account Balance</u>	<u>Deferred Income Tax (Liability) Benefit</u>	<u>Accumulated Other Comprehensive Income (Loss) Related To Net Unrealized Investment Gains (Losses)</u>
	(in thousands)				
Balance, December 31, 2008	\$ -	\$ -	\$ -	\$ -	\$ -
Cumulative impact of the adoption of new authoritative guidance on January 1, 2009	(4,049)	290	-	1,316	(2,443)
Net investment gains (losses) on investments arising during the period	4,471	-	-	(1,565)	2,906
Reclassification adjustment for OTTI losses included in net income	5,080	-	-	(1,778)	3,302
Reclassification adjustment for OTTI losses excluded from net income (1)	(11,483)	-	-	4,019	(7,464)
Impact of net unrealized investment (gains) losses on deferred policy acquisition costs	-	3,363	-	(1,177)	2,186
Impact of net unrealized investment (gains) losses on Policyholder account balance	-	-	(1,383)	484	(899)
Balance, December 31, 2009	<u>\$ (5,981)</u>	<u>\$ 3,653</u>	<u>\$(1,383)</u>	<u>\$ 1,299</u>	<u>\$(2,412)</u>
Net investment gains (losses) on investments arising during the period	(821)	-	-	287	(534)
Reclassification adjustment for OTTI losses included in net income	2,504	-	-	(877)	1,627
Reclassification adjustment for OTTI losses excluded from net income (1)	(11)	-	-	4	(7)
Impact of net unrealized investment (gains) losses on deferred policy acquisition and other costs	-	(1,382)	-	484	(898)
Impact of net unrealized investment (gains) losses on policyholders' account balances	-	-	597	(209)	388
Balance, December 31, 2010	<u>\$ (4,309)</u>	<u>\$ 2,271</u>	<u>\$ (786)</u>	<u>\$ 988</u>	<u>\$(1,836)</u>

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

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

### 3. INVESTMENTS (continued)

All Other Net Unrealized Investment Gains and Losses in AOCI

	Net Unrealized Gains (Losses) On Investments(1)	Deferred Policy Acquisition Costs and Other Costs	Policy Holders Account Balances	Deferred Income Tax (Liability) Benefit	Accumulated Other Comprehensive Income (Loss) Related To Net Unrealized Investment Gains (Losses)
	(in thousands)				
<b>Balance, December 31, 2007</b>	\$ 5,827	\$ (1,183)	\$ 85	\$ (1,655)	\$ 3,074
Net investment (losses) on investments arising during the period	(87,322)	-	-	30,563	(56,759)
Reclassification adjustment for (losses) included in net income	10,575	-	-	(3,702)	6,873
Impact of net unrealized investment gains on deferred policy acquisition and other costs	-	42,376	-	(14,832)	27,544
Impact of net unrealized investment gains on policyholders' account balances	-	-	(17,542)	6,140	(11,402)
<b>Balance, December 31, 2008</b>	<u>\$ (70,920)</u>	<u>\$ 41,193</u>	<u>\$ (17,457)</u>	<u>\$ 16,514</u>	<u>\$ (30,670)</u>
Cumulative impact of the adoption of new authoritative guidance on January 1, 2009	(2,016)	33	-	694	(1,289)
Net investment gains (losses) on investments arising during the period	91,116	-	-	(31,891)	59,225
Reclassification adjustment for gains (losses) included in net income	2,616	-	-	(916)	1,700
Reclassification adjustment for OTTI losses excluded from net income(2)	11,483	-	-	(4,019)	7,464
Impact of net unrealized investment (gains) losses on deferred policy acquisition and other costs	-	(60,878)	-	21,307	(39,571)
Impact of net unrealized investment (gains) losses on policyholders' account balances	-	-	23,727	(8,304)	15,423
<b>Balance, December 31, 2009</b>	<u>\$ 32,279</u>	<u>\$ (19,652)</u>	<u>\$ 6,270</u>	<u>\$ (6,615)</u>	<u>\$ 12,282</u>
Net investment gains (losses) on investments arising during the period	24,868	-	-	(8,703)	16,165
Reclassification adjustment for (gains) losses included in net income	4,166	-	-	(1,458)	2,708
Reclassification adjustment for OTTI losses excluded from net income(2)	11	-	-	(4)	7
Impact of net unrealized investment gains (losses) on deferred policy acquisition and other costs	-	(11,002)	-	3,851	(7,151)
Impact of net unrealized investment (gains) losses on policyholders' account balances	-	-	4,716	(1,651)	3,065
<b>Balance, December 31, 2010</b>	<u>\$ 61,324</u>	<u>\$ (30,654)</u>	<u>\$ 10,986</u>	<u>\$ (14,580)</u>	<u>\$ 27,076</u>

(1) Include cash flow hedges. See Note 11 for information on cash flow hedges.

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

## Pruco Life Insurance Company of New Jersey

### Notes to Financial Statements

#### 3. INVESTMENTS (continued)

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

	<u>December 31,</u> <u>2010</u>	<u>December 31,</u> <u>2009</u>
	( in thousands)	
Fixed maturity securities on which an OTTI loss has been recognized	\$ (4,309)	\$ (5,981)
Fixed maturity securities, available for sale – all other	61,195	31,975
Equity securities, available for sale	(227)	(177)
Derivatives designated as cash flow hedges(1)	(1,100)	(675)
Other investments	<u>1,456</u>	<u>1,156</u>
Net unrealized gain/(losses) on investments	<u>\$57,015</u>	<u>\$26,298</u>

(1) See Note 11 for more information on cash flow hedges.

#### *Duration of Gross Unrealized Loss Positions for Fixed Maturities*

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

	<u>December 31, 2010</u>					
	<u>Less than twelve months</u>		<u>Twelve months or more</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
	(in thousands)					
Fixed maturities available for sale						
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$ 2,078	\$ 41	\$ -	\$ -	\$ 2,078	\$ 41
Obligations of U.S. states and their political subdivisions	-	-	-	-	-	-
Foreign government bonds	-	-	-	-	-	-
Corporate securities	73,679	2,524	6,545	421	80,224	2,945
Commercial mortgage-backed securities.	7,148	87	-	-	7,148	87
Asset-backed securities	10,608	169	16,442	5,277	27,050	5,446
Residential mortgage-backed securities	<u>3,219</u>	<u>48</u>	<u>-</u>	<u>-</u>	<u>3,219</u>	<u>48</u>
Total	<u>\$96,732</u>	<u>\$2,869</u>	<u>\$22,987</u>	<u>\$5,698</u>	<u>\$119,719</u>	<u>\$8,567</u>

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

### 3. INVESTMENTS (continued)

	December 31, 2009					
	Less than twelve months		Twelve months or more(1)		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)					
Fixed maturities available for sale						
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$ 9,622	\$ 268	\$ -	\$ -	\$ 9,622	\$ 268
Obligations of U.S. states and their political subdivisions	-	-	-	-	-	-
Foreign government bonds	6,719	272	-	-	6,719	272
Corporate securities	135,989	2,372	49,634	2,729	185,623	5,101
Commercial mortgage-backed securities.	27,213	337	9,031	388	36,244	725
Asset-backed securities	4,966	2,012	20,868	4,548	25,834	6,560
Residential mortgage-backed securities	5,786	413	-	-	5,786	413
Total	<u>\$190,295</u>	<u>\$5,674</u>	<u>\$79,533</u>	<u>\$7,665</u>	<u>\$269,828</u>	<u>\$13,339</u>

- (1) The month count for aging of unrealized losses was reset back to historical unrealized loss month counts for securities impacted by the adoption of new authoritative guidance related to other-than-temporary impairments of debt securities on January 1, 2009.

The gross unrealized losses at December 31, 2010 and 2009 are composed of \$6 million and \$7 million related to high or highest quality securities based on NAIC or equivalent rating and \$3 million and \$6 million related to other than high or highest quality securities based on NAIC or equivalent rating, respectively. At December 31, 2010, \$5 million of the gross unrealized losses represented declines in value of greater than 20%, none of which had been in that position for less than six months, as compared to \$6 million at December 31, 2009 that represented declines in value of greater than 20%, \$0.5 million of which had been in that position for less than six months. At December 31, 2010, the \$6 million of gross unrealized losses of twelve months or more were concentrated in asset backed securities, and in the utilities and transportation sectors of the Company's corporate securities. At December 31, 2009, the \$8 million of gross unrealized losses of twelve months or more were concentrated in asset backed securities, and in the manufacturing and utilities sectors of the Company's corporate securities. In accordance with its policy described in Note 2, the Company concluded that an adjustment to earnings for other-than-temporary impairments for these securities was not warranted at December 31, 2010 or 2009. These conclusions are based on a detailed analysis of the underlying credit and cash flows on each security. The gross unrealized losses are primarily attributable to credit spread widening and increased liquidity discounts. At December 31, 2010, the Company does not intend to sell the securities and it is not more likely than not that the Company will be required to sell the securities before the anticipated recovery of its remaining amortized cost basis.

#### *Duration of Gross Unrealized Loss Positions for Equity Securities*

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

	December 31, 2010					
	Less than twelve months		Twelve months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)					
Equity Securities, available for sale	<u>\$255</u>	<u>\$245</u>	<u>\$1,536</u>	<u>\$160</u>	<u>\$1,791</u>	<u>\$405</u>

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

### 3. INVESTMENTS (continued)

	December 31, 2009					
	Less than twelve months		Twelve months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)					
Equity Securities, available for sale	\$1,861	\$-	\$1,389	\$306	\$3,250	\$306

At December 31, 2010, \$245 thousand of the gross unrealized losses represented declines of greater than 20%, all of which have been in that position for less than six months. Perpetual preferred securities have characteristics of both debt and equity securities. Since an impairment model similar to fixed maturity securities is applied to these securities, an other-than-temporary impairment has not been recognized on certain perpetual preferred securities that have been in a continuous unrealized loss position for twelve months or more as of September 30, 2010 and December 31, 2009. In accordance with its policy described in Note 2, the Company concluded that an adjustment for other-than-temporary impairments for these equity securities was not warranted at December 31, 2010 or December 31, 2009.

#### *Securities Pledged and Special Deposits*

The Company pledges as collateral investment securities it owns to unaffiliated parties through certain transactions, including securities lending, securities sold under agreements to repurchase and futures contracts. At December 31, the carrying value of investments pledged to third parties as reported in the Statements of Financial Position included the following:

	2010	2009
	(in thousands)	
Fixed maturity securities, available for sale – all other	3,314	31,727
Total securities pledged	\$3,314	\$31,727

As of December 31, 2010, the carrying amount of the associated liabilities supported by the pledged collateral was \$3.4 million. Of this amount, \$3.0 million was “Securities sold under agreements to repurchase” and \$0.4 million was “Cash collateral for loaned securities. As of December 31, 2009, the carrying amount of the associated liabilities supported by the pledged collateral was \$33 million. Of this amount, \$12 million was “Securities sold under agreements to repurchase” and \$21 million was “Cash collateral for loaned securities.”

Fixed maturities of \$0.5 million at December 31, 2010 and 2009 were on deposit with governmental authorities or trustees as required by certain insurance laws.

### 4. DEFERRED POLICY ACQUISITION COSTS

The balances of and changes in deferred policy acquisition costs for the year ended December 31, are as follows:

	2010	2009	2008
	(in thousands)		
Balance, beginning of year	\$305,617	\$326,806	\$273,144
Capitalization of commissions, sales and issue expenses	85,510	57,391	49,675
Amortization	(12,821)	(22,842)	(38,389)
Change in unrealized investment gains/(losses)	(12,336)	(55,738)	42,376
Balance, end of year	\$365,970	\$305,617	\$326,806

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

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### 4. DEFERRED POLICY ACQUISITION COSTS (continued)

Deferred acquisition costs include reductions in capitalization and amortization related to reinsurance expense allowances resulting from the coinsurance treaties with Prudential Arizona Reinsurance Captive Company, or "PARCC," Prudential Arizona Reinsurance Term Company, or "PAR TERM" as discussed in Note 13 to the Consolidated Financial Statements.

Ceded capitalization was \$29 million, \$15 million and \$20 million in 2010, 2009 and 2008, respectively. Ceded amortization relating to this treaty included amounted to \$9 million, \$8 million and \$4 million in 2010, 2009 and 2008, respectively.

### 5. POLICYHOLDERS' LIABILITIES

Future policy benefits at December 31 are as follows:

	<u>2010</u>	<u>2009</u>
	(in thousands)	
Life insurance	\$534,286	\$451,254
Individual and group annuities	6,149	6,140
Policy claims and other liabilities	<u>(37,081)</u>	<u>3,039</u>
Total future policy benefits	<u>\$503,354</u>	<u>\$460,433</u>

Life insurance liabilities include reserves for death benefits and other policy benefits. Individual annuity liabilities include reserves for annuities that are in payout status.

Future policy benefits for life insurance are generally equal to the aggregate of (1) the present value of future benefit payments and related expenses, less the present value of future net premiums, and (2) any premium deficiency reserves. Assumptions as to mortality and persistency are based on the Company's experience, and in certain instances, industry experience, when the basis of the reserve is established. Interest rates range from 2.50% to 7.50 %.

Future policy benefits for individual and group annuities and supplementary contracts are generally equal to the aggregate of (1) the present value of expected future payments, and (2) any premium deficiency reserves. Assumptions as to mortality are based on the Company's experience, and in certain instances, industry experience, when the basis of the reserve is established. The interest rates used in the determination of the present value range from 1.32% to 8.75%, with 5.6% of the reserves based on an interest rate in excess of 8%. Future policy benefits for other contract liabilities are generally equal to the present value of expected future payments based on the Company's experience. The interest rates used in the determination of the present values range from 0.77% to 6.21%.

Policyholders' account balances at December 31 are as follows:

	<u>2010</u>	<u>2009</u>
	(in thousands)	
Interest-sensitive life contracts	\$ 723,533	\$ 677,220
Individual annuities	210,671	247,076
Guaranteed interest accounts	38,713	37,418
Other	<u>80,890</u>	<u>63,304</u>
Total policyholders' account balances	<u>\$1,053,807</u>	<u>\$1,025,018</u>

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

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### 5. POLICYHOLDERS' LIABILITIES (continued)

Policyholders' account balances represent an accumulation of account deposits plus credited interest less withdrawals, expenses and mortality charges, if applicable. Interest crediting rates for interest-sensitive contracts range from 3.00% to 4.90%. Interest crediting rates for individual annuities range from 1.00% to 4.93%. Interest crediting rates for guaranteed interest accounts range from 1.25% to 5.25%. Interest crediting rates range from 1.00% to 3.50% for other.

### 6. REINSURANCE

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

Reinsurance premiums, commissions, expense reimbursements, benefits and reserves related to reinsured long-duration contracts are accounted for over the life of the underlying reinsured contracts using assumptions consistent with those used to account for the underlying contracts. Amounts recoverable from reinsurers for long duration contracts are estimated in a manner consistent with the claim liabilities and policy benefits associated with the reinsured policies. The affiliated reinsurance agreements are described further in Note 13 of the Financial Statements.

Effective April 1, 2008, the Company entered into an agreement to reinsure certain variable Corporate Owned Life Insurance "COLI" policies with Pruco Life.

Reinsurance amounts included in the Statement of Operations and Comprehensive Income for the years ended December 31 are below.

	<u>2010</u>	<u>2009</u>	<u>2008</u>
		(in thousands)	
Gross premiums and policy charges and fee income	\$ 283,990	\$ 267,109	\$ 256,765
Reinsurance ceded	<u>(215,811)</u>	<u>(180,844)</u>	<u>(166,150)</u>
Net premiums and policy charges and fee income	<u>\$ 68,179</u>	<u>\$ 86,265</u>	<u>\$ 90,615</u>
Policyholders' benefits ceded	<u>\$ 95,634</u>	<u>\$ 81,364</u>	<u>\$ 85,156</u>
Realized capital gains (losses) ceded, net	<u>(407)</u>	<u>\$ (44,367)</u>	<u>\$ 48,774</u>

Realized investment gains and losses include the reinsurance of certain of the Company's embedded derivatives. Changes in the fair value of the embedded derivatives are recognized through "Realized investment gains." The Company has entered into reinsurance agreements to transfer the risk related to certain living benefit options to Pruco Re. The reinsurance agreements contain derivatives and have been accounted for in the same manner as an embedded derivative.

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

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

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### 6. REINSURANCE (continued)

Reinsurance recoverables, included in the Company's Statements of Financial Position, at December 31, 2010 and 2009 were \$420 million and \$323 million, respectively.

The gross and net amounts of life insurance in force at December 31, were as follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
		(in thousands)	
Gross life insurance in force	\$ 96,896,483	\$ 95,400,464	\$ 89,008,979
Reinsurance ceded	(86,500,898)	(86,036,509)	(80,943,597)
Net life insurance in force	<u>\$ 10,395,585</u>	<u>\$ 9,363,955</u>	<u>\$ 8,065,382</u>

### 7. CERTAIN NONTRADITIONAL LONG-DURATION CONTRACTS

The Company issues traditional variable annuity contracts through its separate accounts for which investment income and investment gains and losses accrue directly to, and investment risk is borne by, the contractholder. The Company also issues variable annuity contracts with general and separate account options where the Company contractually guarantees to the contractholder a return of no less than (1) total deposits made to the contract less any partial withdrawals ("return of net deposits"), (2) total deposits made to the contract less any partial withdrawals plus a minimum return ("minimum return"), or (3) the highest contract value on a specified date minus any withdrawals ("contract value"). These guarantees include benefits that are payable in the event of death, annuitization or at specified dates during the accumulation period and withdrawal and income benefits payable during specified periods.

The Company also issues annuity contracts with market value adjusted investment options ("MVAs"), which provide for a return of principal plus a fixed rate of return if held to maturity, or, alternatively, a "market adjusted value" if surrendered prior to maturity or if funds are allocated to other investment options. The market value adjustment may result in a gain or loss to the Company, depending on crediting rates or an indexed rate at surrender, as applicable.

In addition, the Company issues variable life, variable universal life and universal life contracts where the Company contractually guarantees to the contractholder a death benefit even when there is insufficient value to cover monthly mortality and expense charges, whereas otherwise the contract would typically lapse ("no lapse guarantee"). Variable life and variable universal life contracts are offered with general and separate account options similar to variable annuities.

The assets supporting the variable portion of both traditional variable annuities and certain variable contracts with guarantees are carried at fair value and reported as "Separate account assets" with an equivalent amount reported as "Separate account liabilities." Amounts assessed against the contractholders for mortality, administration, and other services are included within revenue in "Policy charges and fee income" and changes in liabilities for minimum guarantees are generally included in "Policyholders' benefits." In 2010 and 2009 there were no gains or losses on transfers of assets from the general account to a separate account.

For guarantees of benefits that are payable at annuitization, the net amount at risk is generally defined as the present value of the minimum guaranteed annuity payments available to the contractholder determined in accordance with the terms of the contract in excess of the current account balance. The Company's primary risk exposures for these contracts relates to actual deviations from, or changes to, the assumptions used in the original pricing of these products, including equity market returns, timing of annuitization, contract lapses and contractholder mortality.

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

### 7. CERTAIN NONTRADITIONAL LONG-DURATION CONTRACTS (continued)

For guarantees of benefits that are payable at withdrawal, the net amount at risk is generally defined as the present value of the minimum guaranteed withdrawal payments available to the contractholder determined in accordance with the terms of the contract in excess of the current account balance. For guarantees of accumulation balances, the net amount at risk is generally defined as the guaranteed minimum accumulation balance minus the current account balance. The Company's primary risk exposures for these contracts relates to actual deviations from, or changes to, the assumptions used in the original pricing of these products, including equity market returns, interest rates, market volatility or contractholder behavior used in the original pricing of these products.

The Company's contracts with guarantees may offer more than one type of guarantee in each contract; therefore, the amounts listed may not be mutually exclusive. The liabilities related to the net amount at risk are reflected within "Future policy benefits." As of December 31, 2010 and 2009, the Company had the following guarantees associated with these contracts, by product and guarantee type:

The Company's contracts with guarantees may offer more than one type of guarantee in each contract; therefore, the amounts listed may not be mutually exclusive. The liabilities related to the net amount at risk are reflected within "Future policy benefits." As of December 31, 2010 and 2009, the Company had the following guarantees associated with these contracts, by product and guarantee type:

	December 31, 2010		December 31, 2009	
	In the Event of Death	At Annuitization / Accumulation (1)	In the Event of Death	At Annuitization / Accumulation (1)
Variable Annuity Contracts	(in thousands)		(in thousands)	
<b>Return of Net Deposits</b>				
Account value	\$1,973,903	N/A	\$843,318	N/A
Net amount at risk	\$ 8,252	N/A	\$ 24,037	N/A
Average attained age of contractholders	60 years	N/A	61 years	N/A
<b>Minimum return or contract value</b>				
Account value	\$1,036,830	\$2,392,669	\$688,296	\$ 930,306
Net amount at risk	\$ 36,926	\$ 65,120	\$ 79,173	\$ 58,517
Average attained age of contractholders	64 years	59 years	65 years	60 years
Average period remaining until earliest expected annuitization	N/A	1.58 years	N/A	2.58 years

(1) Includes income and withdrawal as described herein

Market value adjusted annuities	Unadjusted Value	Adjusted Value	Unadjusted Value	Adjusted Value
Account value	\$15,104	\$15,827	\$16,135	\$17,049

	December 31, 2010		December 31, 2009	
	In the Event of Death			
Variable Life, Variable Universal Life and Universal Life Contracts	(in thousands)			
<b>No Lapse Guarantees</b>				
Separate account value	\$569,060	\$508,351		
General account value	\$194,596	\$171,525		
Net amount at risk	\$6,039,086	\$6,080,255		
Average attained age of contractholders	49 years	48 years		

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

### 7. CERTAIN NONTRADITIONAL LONG-DURATION CONTRACTS (continued)

Account balances of variable annuity contracts with guarantees were invested in separate account investment options as follows:

	<u>December 31, 2010</u>	<u>December 31, 2009</u>
	(in thousands)	
Equity funds	\$1,677,692	\$ 812,314
Bond funds	968,140	301,614
Money market funds	165,075	181,001
Total	<u>\$2,810,907</u>	<u>\$1,294,929</u>

In addition to the above mentioned amounts invested in separate account investment options, \$199.8 million and \$236.7 million of account balances of variable annuity contracts with guarantees (inclusive of contracts with MVA features) were invested in general account investment options in 2010 and 2009, respectively.

#### *Liabilities for Guaranteed Benefits*

The table below summarizes the changes in general account liabilities for guarantees on variable contracts. The liabilities for guaranteed minimum death benefits (“GMDB”) and guaranteed minimum income benefits (“GMIB”) are included in “Future policy benefits” and the related changes in the liabilities are included in “Policyholders’ benefits.” Guaranteed minimum income and withdrawal benefits (“GMIWB”), guaranteed minimum withdrawal benefits (“GMWB”) and guaranteed minimum accumulation benefits (“GMAB”) features are considered to be bifurcated embedded derivatives and are recorded at fair value. Changes in the fair value of these derivatives, including changes in the Company’s own risk of non-performance, along with any fees attributed or payments made relating to the derivative, are recorded in “Realized investment gains (losses), net.” See Note 10 for additional information regarding the methodology used in determining the fair value of these embedded derivatives. The liabilities for GMAB, GMWB and GMIWB are included in “Future policy benefits.”

	<u>GMDB</u>	<u>GMIB</u>	<u>GMIWB</u> <u>-GMAB</u>	<u>Total</u>	
	Variable Annuity	Variable Life, Variable Universal Life & Universal Life	Variable Annuity		
	(in thousands)				
Balance as of January 1, 2008	\$ 846	\$ 6,599	\$ 416	\$ 3,087	\$ 10,948
Incurred guarantee benefits(1)	5,636	4,677	1,386	60,816	72,515
Paid guarantee benefits	(889)	-	-	-	(889)
Balance as of December 31, 2008	<u>\$ 5,593</u>	<u>\$11,276</u>	<u>\$1,802</u>	<u>\$ 63,903</u>	<u>\$ 82,574</u>
Incurred guarantee benefits(1)	(1,821)	6,217	(489)	(66,315)	(62,408)
Paid guarantee benefits	(2,288)	(250)	-	-	(2,538)
Balance as of December 31, 2009	<u>\$ 1,484</u>	<u>\$17,243</u>	<u>\$1,313</u>	<u>\$ (2,412)</u>	<u>\$ 17,628</u>
Incurred guarantee benefits(1)	217	1,143	(77)	(38,904)	(37,621)
Paid guarantee benefits	(861)	-	-	-	(861)
Balance as of December 31, 2010	<u>\$ 840</u>	<u>\$18,386</u>	<u>\$1,236</u>	<u>(41,316)</u>	<u>(20,854)</u>

- (1) Incurred guarantee benefits include the portion of assessments established as additions to reserves as well as changes in estimates affecting the reserves. Also includes changes in the fair value of features considered to be embedded derivatives.

# **Pruco Life Insurance Company of New Jersey**

## **Notes to Financial Statements**

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### **7. CERTAIN NONTRADITIONAL LONG-DURATION CONTRACTS (continued)**

The GMDB liability is determined each period end by estimating the accumulated value of a portion of the total assessments to date less the accumulated value of the death benefits in excess of the account balance. The GMIB liability is determined each period by estimating the accumulated value of a portion of the total assessments to date less the accumulated value of the projected income benefits in excess of the account balance. The portion of assessments used is chosen such that, at issue (or, in the case of acquired contracts, at the acquisition date), the present value of expected death benefits or expected income benefits in excess of the projected account balance and the portion of the present value of total expected assessments over the lifetime of the contracts are equal. The Company regularly evaluates the estimates used and adjusts the GMDB and GMIB liability balances, with an associated charge or credit to earnings, if actual experience or other evidence suggests that earlier assumptions should be revised.

The GMAB features provide the contractholder with a guaranteed return of initial account value or an enhanced value if applicable. The most significant of the Company's GMAB features are the guaranteed return option ("GRO") features, which includes an asset transfer feature that reduces the Company's exposure to these guarantees. The GMAB liability is calculated as the present value of future expected payments to customers less the present value of assessed rider fees attributable to the embedded derivative feature.

The GMWB features provide the contractholder with a guaranteed remaining balance if the account value is reduced to zero through a combination of market declines and withdrawals. The guaranteed remaining balance is generally equal to the protected value under the contract, which is initially established as the greater of the account value or cumulative deposits when withdrawals commence, less cumulative withdrawals. The contractholder also has the option, after a specified time period, to reset the guaranteed remaining balance to the then-current account value, if greater. The GMWB liability is calculated as the present value of future expected payments to customers less the present value of assessed rider fees attributable to the embedded derivative feature.

The GMIWB features, taken collectively, provides a contractholder two optional methods to receive guaranteed minimum payments over time, a "withdrawal" option or an "income" option. The withdrawal option (which is available under only one of the Company's GMIWBs) guarantees that a contract holder can withdraw an amount each year until the cumulative withdrawals reach a total guaranteed balance. The income option (which varies among the Company's GMIWBs) in general guarantees the contract holder the ability to withdraw an amount each year for life (or for joint lives, in the case of any spousal version of the benefit) where such amount is equal to a percentage of a protected value under the benefit. The contractholder also has the potential to increase this annual amount, based on certain subsequent increases in account value that may occur. Certain GMIWB features include an asset transfer feature that reduces the Company's exposure to these guarantees. The GMIWB liability is calculated as the present value of future expected payments to customers less the present value of assessed rider fees attributable to the embedded derivative feature.

As part of its risk management strategy, the Company limits its exposure to these risks through a combination of product design elements, such as an asset transfer feature, and affiliated reinsurance agreements. The asset transfer feature included in the design of certain optional living benefits transfers assets between the variable investments selected by the annuity contractholder and, depending on the benefit feature, a fixed rate account in the general account or a bond portfolio within the separate account. The transfers are based on the static mathematical formula, used with the particular optional benefit, which considers a number of factors, including the impact of investment performance of the contractholder total account value. In general, negative investment performance may result in transfers to a fixed-rate account in the general account or a bond portfolio within the separate account, and positive investment performance may result in transfers back to contractholder-selected investments. Other product design elements utilized for certain products to manage these risks include asset allocation restrictions and minimum purchase age requirements. For risk management purposes the Company segregates the variable annuity living benefit features into those that include the asset transfer feature including certain GMIWB riders and certain GMAB riders that feature the GRO policyholder benefits; and those that do

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

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### 7. CERTAIN NONTRADITIONAL LONG-DURATION CONTRACTS (continued)

not include the asset transfer feature, including certain legacy GMIWB, GMWB, GMAB and GMIB riders. Living benefit riders that include the asset transfer feature also include GMDB riders, and as such the GMDB risk in these riders also benefits from the asset transfer feature

#### *Sales Inducements*

These inducements include: (1) a bonus whereby the policyholder's initial account balance is increased by an amount equal to a specified percentage of the customer's initial deposit and (2) additional credits after a certain number of years a contract is held. Changes in deferred sales inducements, reported as "Interest credited to policyholders' account balances", are as follows:

The Company defers sales inducements and amortizes them over the life of the policy using the same methodology and assumptions used to amortize deferred policy acquisition costs. These deferred sales inducements are included in "Other Assets" in the Company's Statements of Financial Position. The Company offers various types of sales inducements. These inducements include: (1) a bonus whereby the policyholder's initial account balance is increased by an amount equal to a specified percentage of the customer's initial deposit and (2) additional credits after a certain number of years a contract is held. Changes in deferred sales inducements, reported as "Interest credited to policyholders' account balances," are as follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
		(in thousands)	
Balance, beginning of year	\$30,265	\$28,015	\$21,957
Capitalization	21,594	8,689	6,959
Amortization	(705)	(4,663)	(901)
Change in unrealized investment gains and (losses)	(48)	(1,776)	-
Balance, end of year	<u>51,106</u>	<u>30,265</u>	<u>28,015</u>

### 8. STATUTORY NET INCOME AND SURPLUS AND DIVIDEND RESTRICTIONS

The Company is required to prepare statutory financial statements in accordance with accounting practices prescribed or permitted by the New Jersey Department of Banking and Insurance. Statutory accounting practices primarily differ from GAAP by charging policy acquisition costs to expense as incurred, establishing future policy benefit liabilities using different actuarial assumptions and valuing investments, deferred taxes, and certain assets on a different basis.

Statutory net income (loss) of the Company amounted to \$52 million, \$4 million, and \$(22) million for the years ended December 31, 2010, 2009 and 2008, respectively. Statutory surplus of the Company amounted to \$216 million and \$160 million at December 31, 2010 and 2009, respectively.

The Company prepares its statutory financial statements in accordance with accounting practices prescribed or permitted by the New Jersey Department of Banking and Insurance. Prescribed statutory accounting practices include publications of the NAIC, state laws, regulations, and general administrative rules. Permitted statutory accounting practices encompass all accounting practices not so prescribed.

The Company is subject to New Jersey law, which limits the amount of dividends that insurance companies can pay to stockholders without approval of the New Jersey Department of Banking and Insurance. The maximum dividend, which may be paid in any twelve-month period without notification or approval, is limited to the greater of 10% of statutory surplus as of December 31 of the preceding year or the net gain from operations of

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

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### 8. STATUTORY NET INCOME AND SURPLUS AND DIVIDEND RESTRICTIONS (continued)

the preceding calendar year. Cash dividends may only be paid out of surplus derived from realized net profits. Based on these limitations, there is \$49 million capacity to pay a dividend in 2011 without prior approval. The Company did not pay any dividends in 2010.

### 9. INCOME TAXES

The components of income tax expense (benefit) for the years ended December 31, were as follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
	(in thousands)		
<b>Current tax expense (benefit):</b>			
U.S.	\$23,841	\$20,362	\$ 1,033
Total	<u>23,841</u>	<u>20,362</u>	<u>1,033</u>
<b>Deferred tax expense (benefit):</b>			
U.S.	19,701	644	3,085
Total	<u>19,701</u>	<u>644</u>	<u>3,085</u>
Total income tax expense (benefit) on income from continuing operations	\$43,542	\$21,006	\$ 4,118
Other comprehensive income (loss) . . . . .	8,264	21,850	(18,213)
Cumulative effect of changes in accounting policy . . . . .	-	2,010	-
Total income tax expense (benefit) on continuing operations	<u>\$51,806</u>	<u>\$44,866</u>	<u>\$ 14,095</u>

The Company's income (loss) from continuing operations before income taxes includes income (loss) from domestic operations of \$141.5 million, \$76.0 million and \$25.8 million, and no income from foreign operations for the years ended December 31, 2010, 2009 and 2008, respectively.

The Company's actual income tax expense for the years ended December 31, differs from the expected amount computed by applying the statutory federal income tax rate of 35% to income from continuing operations before income taxes and cumulative effect of accounting change for the following reasons:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
	(in thousands)		
Expected federal income tax expense (benefit)	\$49,520	\$26,610	\$ 9,038
Non-taxable investment income	(4,449)	(3,240)	(4,573)
Tax Credits	(362)	(195)	-
Expiration of statute of limitations and related interest	-	(2,695)	-
Other	<u>(1,167)</u>	<u>526</u>	<u>(347)</u>
Total income tax expense (benefit) on income from continuing operations	<u>\$43,542</u>	<u>\$21,006</u>	<u>\$ 4,118</u>

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

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### 9. INCOME TAXES (continued)

Deferred tax assets and liabilities at December 31, resulted from the items listed in the following table:

	<u>2010</u>	<u>2009</u>
	(in thousands)	
<b>Deferred tax assets</b>		
Investments	\$ -	\$ 5,219
Other	7,252	7,222
Deferred tax assets	<u>\$ 7,252</u>	<u>\$ 12,441</u>
<b>Deferred tax liabilities</b>		
Insurance reserves	\$ 14,489	\$ 21,398
Deferred acquisition costs	85,442	67,816
Investments	1,159	-
Net Unrealized gains on securities	20,341	9,441
Deferred tax liabilities	<u>\$ 121,431</u>	<u>\$ 98,655</u>
Net deferred tax asset (liability)	<u><u>\$(114,179)</u></u>	<u><u>\$(86,214)</u></u>

The application of U.S. GAAP requires the Company to evaluate the recoverability of deferred tax assets and establish a valuation allowance if necessary to reduce the deferred tax asset to an amount that is more likely than not expected to be realized. Considerable judgment is required in determining whether a valuation allowance is necessary, and if so, the amount of such valuation allowance. In evaluating the need for a valuation allowance the Company considers many factors, including: (1) the nature of the deferred tax assets and liabilities; (2) whether they are ordinary or capital; (3) in which tax jurisdictions they were generated and the timing of their reversal; (4) taxable income in prior carryback years as well as projected taxable earnings exclusive of reversing temporary differences and carryforwards; (5) the length of time that carryovers can be utilized in the various taxing jurisdictions; (6) any unique tax rules that would impact the utilization of the deferred tax assets; and (7) any tax planning strategies that the Company would employ to avoid a tax benefit from expiring unused. Although realization is not assured, management believes it is more likely than not that the deferred tax assets, net of valuation allowances, will be realized. The company had no valuation allowance as of December 31, 2010, 2009 and 2008.

Management believes that based on its historical pattern of taxable income, the Company will produce sufficient income in the future to realize its deferred tax assets. Adjustments to the valuation allowance will be made if there is a change in management's assessment of the amount of deferred tax asset that is realizable.

## Pruco Life Insurance Company of New Jersey

### Notes to Financial Statements

#### 9. INCOME TAXES (continued)

The Company's unrecognized tax benefits for the periods indicated are as follows:

	<u>Unrecognized tax benefits prior to 2002</u>	<u>Unrecognized tax benefits 2002 and forward</u>	<u>Total unrecognized tax benefits all years</u>
		(in thousands)	
Amounts as of December 31, 2007	\$ 3,596	\$ 1,470	\$ 5,066
Increases in unrecognized tax benefits taken in prior period	-	47	47
(Decreases) in unrecognized tax benefits taken in prior period	-	-	-
Amounts as of December 31, 2008	\$ 3,596	\$ 1,517	\$ 5,113
Increases in unrecognized tax benefits taken in prior period	-	-	-
(Decreases) in unrecognized tax benefits taken in prior period	-	(210)	(210)
Settlements with taxing authorities	-	-	-
(Decreases) in unrecognized tax benefits as a result of the applicable statute of limitations	(2,107)	-	(2,107)
Amounts as of December 31, 2009	\$ 1,489	1,307	2,796
Increases in unrecognized tax benefits taken in prior period	-	-	-
(Decreases) in unrecognized tax benefits taken in prior period	-	(1,177)	(1,177)
Amounts as of December 31, 2010	<u>\$ 1,489</u>	<u>130</u>	<u>\$ 1,619</u>
Unrecognized tax benefits that, if recognized, would favorably impact the effective rate as of December 31, 2008	<u>\$ 3,596</u>	<u>\$ -</u>	<u>\$ 3,596</u>
Unrecognized tax benefits that, if recognized, would favorably impact the effective rate as of December 31, 2009	<u>\$ 1,489</u>	<u>\$ -</u>	<u>\$ 1,489</u>
Unrecognized tax benefits that, if recognized, would favorably impact the effective rate as of December 31, 2010	<u>\$ 1,489</u>	<u>\$ -</u>	<u>\$ 1,489</u>

The Company classifies all interest and penalties related to tax uncertainties as income tax expense (benefit). The amounts recognized in the financial statements for tax-related interest and penalties for the years ended December 31, are as follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
	(in thousands)		
Interest and penalties recognized in the statements of operations	\$(1,100)	\$ 400	\$100
Interest and penalties recognized in liabilities in the statements of financial position	\$ -	\$1,100	\$700

The Company's liability for income taxes includes the liability for unrecognized tax benefits, interest and penalties which relate to tax years still subject to review by the Internal Revenue Service ("IRS") or other taxing authorities. Audit periods remain open for review until the statute of limitations has passed. Generally, for tax years which produce net operating losses, capital losses or tax credit carryforwards ("tax attributes"), the statute of limitations does not close, to the extent of these tax attributes, until the expiration of the statute of limitations for the tax year in which they are fully utilized. The completion of review or the expiration of the statute of limitations for a given audit period could result in an adjustment to the liability for income taxes. The statute of limitations for the 2002 tax year expired on April 30, 2009. The statute of limitations for the 2003 tax year

# **Pruco Life Insurance Company of New Jersey**

## **Notes to Financial Statements**

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### **9. INCOME TAXES (continued)**

expired on July 31, 2009. The statute of limitations for the 2004 through 2007 tax years will expire in February 2012, unless extended. Tax years 2008 and 2009 are still open for IRS examination. The Company does not anticipate any significant changes within the next 12 months to its total unrecognized tax benefits related to tax years for which the statute of limitations has not expired.

As discussed above, the completion of review or the expiration of the statute of limitations for a given audit period could result in an adjustment to the liability for income taxes. As such, 2009 benefited from a reduction to the liability for unrecognized tax benefits and related interest of \$3 million, primarily related to tax years prior to 2002 as a result of the expiration of the statute of limitations for the 2002 and 2003 tax years.

The dividends received deduction (“DRD”) reduces the amount of dividend income subject to U.S. tax and is the primary component of the non-taxable investment income shown in the table above, and, as such, is a significant component of the difference between the Company’s effective tax rate and the federal statutory tax rate of 35%. The DRD for the current period was estimated using information from 2009, current year results, and was adjusted to take into account the current year’s equity market performance. The actual current year DRD can vary from the estimate based on factors such as, but not limited to, changes in the amount of dividends received that are eligible for the DRD, changes in the amount of distributions received from mutual fund investments, changes in the account balances of variable life and annuity contracts, and the Company’s taxable income before the DRD.

In August 2007, the IRS released Revenue Ruling 2007-54, which included, among other items, guidance on the methodology to be followed in calculating the DRD related to variable life insurance and annuity contracts. In September 2007, the IRS released Revenue Ruling 2007-61. Revenue Ruling 2007-61 suspended Revenue Ruling 2007-54 and informed taxpayers that the U.S. Treasury Department and the IRS intend to address through new regulations the issues considered in Revenue Ruling 2007-54, including the methodology to be followed in determining the DRD related to variable life insurance and annuity contracts. On February 14, 2011, the Obama Administration released the “General Explanations of the Administration’s Revenue Proposals.” Although the Administration has not released proposed statutory language, one proposal would change the method used to determine the amount of the DRD. A change in the DRD, including the possible retroactive or prospective elimination of this deduction through regulation or legislation, could increase actual tax expense and reduce the Company’s consolidated net income. These activities had no impact on the Company’s 2008, 2009 or 2010 results.

In December 2006, the IRS completed all fieldwork with respect to its examination of the consolidated federal income tax returns for tax years 2002 and 2003. The final report was initially submitted to the Joint Committee on Taxation for their review in April 2007. The final report was resubmitted in March 2008 and again in April 2008. The Joint Committee returned the report to the IRS for additional review of an industry issue regarding the methodology for calculating the DRD related to variable life insurance and annuity contracts. The IRS completed its review of the issue and proposed an adjustment with respect to the calculation of the DRD. In order to expedite receipt of an income tax refund related to the 2002 and 2003 tax years, the Company agreed to such adjustment. The report, with the adjustment to the DRD, was submitted to the Joint Committee on Taxation in October 2008. The Company was advised on January 2, 2009 that the Joint Committee completed its consideration of the report and took no exception to the conclusions reached by the IRS. Accordingly, the final report was processed and a \$157 million refund was received in February 2009. The Company believed that its return position with respect to the calculation of the DRD was technically correct. Therefore, the Company filed protective refund claims on October 1, 2009 to recover the taxes associated with the agreed upon adjustment. The IRS recently issued an Industry Director Directive (“IDD”) stating that the methodology for calculating the DRD

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

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### 9. INCOME TAXES (continued)

set forth in Revenue Ruling 2007-54 should not be followed. The IDD also confirmed that the IRS guidance issued before Revenue Ruling 2007-54, which guidance the Company relied upon in calculating its DRD, should be used to determine the DRD. The Company is working with its IRS audit team to bring the DRD issue to a close in accordance with the IDD. These activities had no impact on the Company's 2008, 2009 or 2010 results.

In January 2007, the IRS began an examination of tax years 2004 through 2006. For tax years 2007 through 2010, the Company is participating in the IRS's Compliance Assurance Program ("CAP"). Under CAP, the IRS assigns an examination team to review completed transactions contemporaneously during these tax years in order to reach agreement with the Company on how they should be reported in the tax returns. If disagreements arise, accelerated resolutions programs are available to resolve the disagreements in a timely manner before the tax returns are filed. It is management's expectation this program will shorten the time period between the filing of the Company's federal income tax returns and the IRS's completion of its examination of the returns.

### 10. FAIR VALUE OF ASSETS AND LIABILITIES

**Fair Value Measurement** – Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The authoritative guidance around fair value established a framework for measuring fair value that includes a hierarchy used to classify the inputs used in measuring fair value. The hierarchy prioritizes the inputs to valuation techniques into three levels. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement. The levels of the fair value hierarchy are as follows:

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

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

# **Pruco Life Insurance Company of New Jersey**

## **Notes to Financial Statements**

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### **10. FAIR VALUE OF ASSETS AND LIABILITIES (continued)**

Level 3 – Fair value is based on at least one or more significant unobservable inputs for the asset or liability. These inputs reflect the Company’s assumptions about the inputs market participants would use in pricing the asset or liability. The Company’s Level 3 assets and liabilities primarily include: certain private fixed maturities and equity securities, certain manually priced public equity securities and fixed maturities, certain highly structured over-the-counter derivative contracts, certain consolidated real estate funds for which the Company is the general partner, and embedded derivatives resulting from certain products with guaranteed benefits. Prices are determined using valuation methodologies such as option pricing models, discounted cash flow models and other similar techniques. Non-binding broker quotes, which are utilized when pricing service information is not available, are reviewed for reasonableness based on the Company’s understanding of the market, and are generally considered Level 3. Under certain conditions, based on its observations of transactions in active markets, the Company may conclude the prices received from independent third party pricing services or brokers are not reasonable or reflective of market activity. In those instances, the Company may choose to over-ride the third-party pricing information or quotes received and apply internally developed values to the related assets or liabilities. To the extent the internally developed valuations use significant unobservable inputs, they are classified as Level 3. As of December 31, 2010 and 2009 these over-rides on a net basis were not material.

**Inactive Markets** – During 2009 and continuing through the first quarter of 2010, the Company observed that the volume and level of activity in the market for asset-backed securities collateralized by sub-prime mortgages remained at historically low levels. This stood in particular contrast to the markets for other structured products with similar cash flow and credit profiles. The Company also observed significant implied relative liquidity risk premiums, yields, and weighting of “worst case” cash flows for asset-backed securities collateralized by sub-prime mortgages in comparison with its own estimates for such securities. In contrast, the liquidity of other spread-based asset classes, such as corporate bonds, high yield and consumer asset-backed securities, such as those collateralized by credit cards or auto loans, which were previously more correlated with sub-prime securities, improved beginning in the second quarter of 2009. Based on this information, the Company concluded as of June 30, 2009, and continuing through March 31, 2010 that the market for asset-backed securities collateralized by sub-prime mortgages was inactive and also determined the pricing quotes it received were based on limited market transactions, calling into question their representation of observable fair value. As a result, the Company considered both third-party pricing information and an internally developed price based on a discounted cash flow model in determining the fair value of certain of these securities as of June 30, 2009 through March 31, 2010. Based on the unobservable inputs used in the discounted cash flow model and the limited observable market activity, the Company classified these securities within Level 3 as of June 30, 2009 through March 31, 2010.

Beginning in the second quarter of 2010, the Company observed an increasingly active market, as evidence of orderly transactions in asset-backed securities collateralized by sub-prime mortgages became more apparent. Additionally, the valuation based on the pricing the Company received from independent pricing services was not materially different from its internal estimates of current market value for these securities. As a result, where third party pricing information based on observable inputs was used to fair value the security, and based on the assessment that the market has been becoming increasingly active, the Company reported fair values for these asset-backed securities collateralized by sub-prime mortgages in Level 2 since June 30, 2010. As of December 31, 2010, the fair value of these securities included in Level 2 was \$14.2 million included in Fixed Maturities Available for Sale – Asset-Backed Securities.

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

### 10. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

**Assets and Liabilities by Hierarchy Level** – The tables below present the balances of assets and liabilities measured at fair value on a recurring basis, as of the dates indicated.

	As of December 31, 2010			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Fixed maturities, available for sale:				
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$ -	\$ 36,450	\$ -	\$ 36,450
Foreign government bonds	-	22,678	-	22,678
Corporate securities	-	748,645	3,636	752,281
Asset-backed securities	-	37,414	16,619	54,033
Commercial mortgage-backed securities	-	103,101	-	103,101
Residential mortgage-backed securities	-	95,998	-	95,998
Sub-total	-	1,044,286	20,254	1,064,541
Equity securities, available for sale	283	1,536	255	2,074
Short-term investments	359	7,050	-	7,409
Cash equivalents	5,000	23,383	-	28,383
Other long-term investments	-	-	-	-
Other assets	-	2,792	16,996	19,788
Sub-total excluding separate account assets	642	1,079,047	37,505	1,122,125
Separate account assets(1)	132,005	4,900,653	5,393	5,038,051
Total assets	<u>\$132,647</u>	<u>\$5,979,700</u>	<u>\$ 42,898</u>	<u>\$6,160,176</u>
Other liabilities	-	898	-	898
Future policy benefits	-	-	(41,316)	(41,316)
Total liabilities	<u>\$ -</u>	<u>\$ 898</u>	<u>\$(41,316)</u>	<u>\$ (40,418)</u>

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

### 10. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

	As of December 31, 2009(2)			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Fixed maturities, available for sale:				
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$ -	\$ 70,519	\$ -	\$ 70,519
Foreign government bonds	-	23,148	-	23,148
Corporate securities	-	687,694	2,398	690,092
Asset-backed securities	-	31,586	25,259	56,845
Commercial mortgage-backed securities	-	93,466	-	93,466
Residential mortgage-backed securities	-	120,310	-	120,310
Sub-total	-	1,026,723	27,657	1,054,380
Equity securities, available for sale	-	3,250	576	3,826
Short-term investments	17	27,959	-	27,976
Cash equivalents	-	30,483	-	30,483
Other assets	-	3,019	16,039	19,058
Sub-total excluding separate account assets	17	1,091,434	44,272	1,135,723
Separate account assets(1)	48,582	3,208,204	5,104	3,261,890
Total assets	<u>\$48,599</u>	<u>\$4,299,638</u>	<u>\$49,376</u>	<u>\$4,397,613</u>
Future policy benefits	-	-	(2,412)	(2,412)
Other liabilities	-	3,442	67	3,509
Total liabilities	<u>\$ -</u>	<u>\$ 3,442</u>	<u>\$ (2,345)</u>	<u>\$ 1,097</u>

(1) Separate account assets represent segregated funds that are invested for certain customers. Investment risks associated with market value changes are borne by the customers, except to the extent of minimum guarantees made by the Company with respect to certain accounts. Separate account assets classified as Level 3 consist primarily of real estate and real estate investment funds. Separate account liabilities are not included in the above table as they are reported at contract value and not fair value in the Company's Statement of Financial Position.

(2) Includes reclassifications to conform to current period presentation.

The methods and assumptions the Company uses to estimate fair value of assets and liabilities measured at fair value on a recurring basis are summarized below. Information regarding Separate Account Assets is excluded as the risk of assets for these categories is primarily borne by our customers and policyholders.

**Fixed Maturity Securities** – The fair values of the Company's public fixed maturity securities are generally based on prices obtained from independent pricing services. Prices from pricing services are sourced from multiple vendors, and a vendor hierarchy is maintained by asset type based on historical pricing experience and vendor expertise. The Company generally receives prices from multiple pricing services for each security, but ultimately uses the price from the pricing service highest in the vendor hierarchy based on the respective asset type. To validate reasonability, prices are reviewed by internal asset managers through comparison with directly observed recent market trades and internal estimates of current fair value, developed using market observable inputs and economic indicators. Consistent with the fair value hierarchy described above, securities with validated quotes from pricing services are generally reflected within Level 2, as they are primarily based on

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

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### 10. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

observable pricing for similar assets and/or other market observable inputs. If the pricing information received from third party pricing services is not reflective of market activity or other inputs observable in the market, the Company may challenge the price through a formal process with the pricing service. If the pricing service updates the price to be more consistent in comparison to the presented market observations, the security remains within Level 2.

If the Company ultimately concludes that pricing information received from the independent pricing service is not reflective of market activity, non-binding broker quotes are used, if available. If the Company concludes the values from both pricing services and brokers are not reflective of market activity, it may over-ride the information from the pricing service or broker with an internally developed valuation. As of December 31, 2010 and 2009 over-rides on a net basis were not material. Internally developed valuations or non-binding broker quotes are also used to determine fair value in circumstances where vendor pricing is not available. These estimates may use significant unobservable inputs, which reflect our own assumptions about the inputs market participants would use in pricing the asset. Circumstances where observable market data are not available may include events such as market illiquidity and credit events related to the security. Pricing service over-rides, internally developed valuations and non-binding broker quotes are generally included in Level 3 in our fair value hierarchy.

The fair value of private fixed maturities, which are primarily comprised of investments in private placement securities, originated by internal private asset managers, are primarily determined using a discounted cash flow model. In certain cases these models primarily use observable inputs with a discount rate based upon the average of spread surveys collected from private market intermediaries who are active in both primary and secondary transactions, taking into account, among other factors, the credit quality and industry sector of the issuer and the reduced liquidity associated with private placements. Generally, these securities have been reflected within Level 2. For certain private fixed maturities, the discounted cash flow model may also incorporate significant unobservable inputs, which reflect the Company's own assumptions about the inputs market participants would use in pricing the asset. To the extent management determines that such inputs are not significant to the price of a security, a Level 2 classification is made. Otherwise, a Level 3 classification is used.

Private fixed maturities also include debt investments in funds that, in addition to a stated coupon, pay a return based upon the results of the underlying portfolios. The fair values of these securities are determined by reference to the funds' net asset value (NAV). Since the NAV at which the funds trade can be observed by redemption and subscription transactions between third parties, the fair values of these investments have been reflected within Level 2 in the fair value hierarchy.

**Equity Securities** – Equity securities consist principally of investments in common and preferred stock of publicly traded companies, privately traded securities as well as common stock mutual fund shares. The fair values of most publicly traded equity securities are based on quoted market prices in active markets for identical assets and are classified within Level 1 in the fair value hierarchy. The fair values of preferred equity securities are based on prices obtained from independent pricing services and, in order to validate reasonability, are compared with directly observed recent market trades. Accordingly, these securities are generally classified within Level 2 in the fair value hierarchy.

**Derivative Instruments** – Derivatives are recorded at fair value either as assets, within “Other long-term investments,” or as liabilities, within “Other liabilities,” except for embedded derivatives which are recorded with the associated host contract. The fair values of derivative contracts are determined based on quoted prices in active exchanges or through the use of valuation models. The fair values of derivative contracts can be affected

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

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### 10. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

by changes in interest rates, foreign exchange rates, credit spreads, market volatility, expected returns, non-performance risk and liquidity as well as other factors. Liquidity valuation adjustments are made to reflect the cost of exiting significant risk positions, and consider the bid-ask spread, maturity, complexity, and other specific attributes of the underlying derivative position. Fair values can also be affected by changes in estimates and assumptions including those related to counterparty behavior used in valuation models.

All of the Company's derivative positions are traded in the over-the-counter (OTC) derivative market and is classified within Level 2 in the fair value hierarchy. OTC derivatives classified within Level 2 are valued using models generally accepted in the financial services industry that use actively quoted or observable market input values from external market data providers, third-party pricing vendors and/or recent trading activity. The fair values of most OTC derivatives, including interest rate and cross currency swaps, are determined using discounted cash flow models. These models' key assumptions include the contractual terms of the respective contract, along with significant observable inputs, including interest rates, currency rates, credit spreads, equity prices, index dividend yields, non-performance risk and volatility and are classified as Level 2.

To reflect the market's perception of its own and the counterparty's non-performance risk, the Company incorporates an additional spread over London Interbank Offered Rate ("LIBOR") into the discount rate used in determining the fair value of OTC derivative assets and liabilities which are uncollateralized. Most OTC derivative contracts inputs have bid and ask prices that are actively quoted or can be readily obtained from external market data providers. The Company's policy is to use mid-market pricing in determining its best estimate of fair value and classify these derivative contracts as Level 2.

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

**Cash Equivalents and Short-Term Investments** – Include money market instruments, commercial paper and other highly liquid debt instruments. Money market instruments are generally valued using unadjusted quoted prices in active markets that are accessible for identical assets and are primarily classified as Level 1. The remaining instruments in the Cash Equivalents and Short-term Investments category are typically not traded in active markets; however, their fair values are based on market observable inputs and, accordingly, these investments have been classified within Level 2 in the fair value hierarchy.

**Other Assets** – Other assets carried at fair value include reinsurance recoverables related to the reinsurance of our living benefit guarantees on certain of our variable annuities. These guarantees are described further below in "Future Policy Benefits." The reinsurance agreements covering these guarantees are derivatives and are accounted for in the same manner as an embedded derivative.

**Future Policy Benefits** – The liability for future policy benefits includes general account liabilities for guarantees on variable annuity contracts, including guaranteed minimum accumulation benefits ("GMAB") and guaranteed minimum income and withdrawal benefits ("GMIWB"), accounted for as embedded derivatives. The fair values of the GMAB and GMIWB liabilities are calculated as the present value of future expected benefit payments to customers less the present value of assessed rider fees attributable to the embedded derivative feature. Since there is no observable active market for the transfer of these obligations, the valuations are

## **Pruco Life Insurance Company of New Jersey**

### **Notes to Financial Statements**

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#### **10. FAIR VALUE OF ASSETS AND LIABILITIES (continued)**

calculated using internally developed models with option pricing techniques. The models are based on a risk neutral valuation framework and incorporate premiums for risks inherent in valuation techniques, inputs, and the general uncertainty around the timing and amount of future cash flows. The determination of these risk premiums requires the use of management judgment.

The Company is also required to incorporate the market perceived risk of its own non-performance in the valuation of the embedded derivatives associated with its optional living benefit features and no-lapse feature on certain universal life products. Since insurance liabilities are senior to debt, the Company believes that reflecting the financial strength ratings of the Company in the valuation of the liability appropriately takes into consideration the Company's own risk of non-performance. To reflect the market's perception of its non-performance risk the Company incorporates an additional spread over LIBOR into the discount rate used in the valuations of the embedded derivatives associated with its optional living benefit features. The additional spread over LIBOR is determined taking into consideration publicly available information relating to the financial strength of the Company, as indicated by the credit spreads associated with funding agreements issued by these affiliated companies. The Company adjusts these credit spreads to remove any liquidity risk premium. The additional spread over LIBOR incorporated into the discount rate as of December 31, 2010 generally ranged from 50 to 150 basis points for the portion of the interest rate curve most relevant to these liabilities.

Other significant inputs to the valuation models for the embedded derivatives associated with the optional living benefit features of the Company's variable annuity products include capital market assumptions, such as interest rate and implied volatility assumptions, as well as various policyholder behavior assumptions that are actuarially determined, including lapse rates, benefit utilization rates, mortality rates and withdrawal rates. These assumptions are reviewed at least annually, and updated based upon historical experience and give consideration to any observable market data, including market transactions such as acquisitions and reinsurance transactions. Since many of the assumptions utilized in the valuation of the embedded derivatives associated with the Company's optional living benefit features are unobservable and are considered to be significant inputs to the liability valuation, the liability included in future policy benefits has been reflected within Level 3 in the fair value hierarchy.

**Transfers between Levels 1 and 2** – During the year ended December 31, 2010, there were no material transfers between Level 1 and Level 2.

## Pruco Life Insurance Company of New Jersey

### Notes to Financial Statements

#### 10. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

**Changes in Level 3 assets and liabilities** – The following tables provide a summary of the changes in fair value of Level 3 assets and liabilities for the year ended December 31, 2010, as well as the portion of gains or losses included in income for the year ended December 31, 2010 attributable to unrealized gains or losses related to those assets and liabilities still held at December 31, 2010.

	Year Ended December 31, 2010			
	Fixed Maturities, Available For Sale – Corporate Securities	Fixed Maturities, Available For Sale – Asset-Backed Securities	Equity Securities, Available for Sale	Other Assets
	(in thousands)			
Fair value, beginning of period	\$2,398	\$ 25,259	\$ 576	\$16,039
Total gains or (losses) (realized/unrealized):				
Included in earnings:				
Realized investment gains (losses), net	8	(139)	-	(443)
Asset management fees and other income	-	-	-	-
Included in other comprehensive income (loss)	514	(1,258)	(374)	263
Net investment income	34	164	-	-
Purchases, sales, issuances, and settlements	(149)	9,049	53	1,137
Foreign currency translation	-	-	-	-
Transfers into Level 3(2)	957	-	-	-
Transfers out of Level 3(2)	(127)	(16,456)	-	-
Fair value, end of period	<u>\$3,636</u>	<u>\$ 16,619</u>	<u>\$ 255</u>	<u>\$16,996</u>
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(3):				
Included in earnings:				
Realized investment gains (losses), net:	\$ 10	\$ (41)	\$ -	\$ (303)
Asset management fees and other income	\$ -	\$ -	\$ -	\$ -
Interest credited to policyholder account balances .	\$ -	\$ -	\$ -	\$ -
Included in other comprehensive income (loss)	\$ 514	\$ (1,258)	\$(374)	\$ 263

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

### 10. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

	<u>Separate Account Assets(1)</u>	<u>Future Policy Benefits</u>	<u>Other Liabilities</u>
	(in thousands)		
Fair value, beginning of period	\$5,104	\$ 2,412	\$(67)
Total gains or (losses) (realized/unrealized):			
Included in earnings:			
Realized investment gains (losses), net	-	47,655	67
Asset management fees and other income	-	-	-
Interest credited to policyholder account balances	289	-	-
Included in other comprehensive income	-	-	-
Net investment income	-	-	-
Purchases, sales, issuances, and settlements	-	(8,751)	-
Foreign Currency Translation	-	-	-
Transfers into Level 3(2)	-	-	-
Transfers out of Level 3(2)	-	-	-
Fair value, end of period	<u>\$5,393</u>	<u>\$41,316</u>	<u>\$(67)</u>
Unrealized gains(losses) for the period relating to those level 3 assets that were still held at the end of the period (3):			
Included in earnings:			
Realized investment gains (losses), net	\$ -	\$ 8,290	\$ 70
Asset management fees and other income	\$ -	\$ -	-
Interest credited to policyholder account balances	\$ 289	\$ -	\$ -
Included in other comprehensive income	\$ -	\$ -	\$ -

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

**Transfers** – Transfers out of Level 3 for Fixed Maturities Available for Sale – Asset-Backed Securities totaled \$15.3 million for the year ended December 31, 2010 resulting from the Company's conclusion that the market for asset-backed securities collateralized by sub-prime mortgages has been becoming increasingly active, as evidenced by orderly transactions. The pricing received from independent pricing services could be validated by the Company, as discussed in detail above. Other transfers out of Level 3 were typically due to the use of observable inputs in valuation methodologies as well as the utilization of pricing service information for certain assets that the Company was able to validate. Transfers into Level 3 were primarily the result of significant unobservable inputs utilized within valuation methodologies and the use of broker quotes (that could not be validated) when previously, information from third party pricing services (that could be validated) was utilized.

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

### 10. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

**Changes in Level 3 assets and liabilities** – The following tables provide a summary of the changes in fair value of Level 3 assets and liabilities for the year ended December 31, 2009, as well as the portion of gains or losses included in income for the year ended December 31, 2009 attributable to unrealized gains or losses related to those assets and liabilities still held at December 31, 2009.

	<b>Year Ended December 31, 2009</b>			
	<b>Fixed Maturities, Available For Sale – Corporate Securities</b>	<b>Fixed Maturities, Available For Sale – Asset-Backed Securities</b>	<b>Equity Securities, Available for Sale</b>	<b>Other Assets</b>
	(in thousands)			
Fair value, beginning of period	\$ 266	\$ 5,732	\$121	\$ 58,880
Total gains or (losses) (realized/unrealized):				
Included in earnings:				
Realized investment gains (losses), net	(506)	(1,634)	-	(44,396)
Asset management fees and other income	-	-	-	-
Included in other comprehensive income (loss)	449	9,708	455	590
Net investment income	(1)	121	-	-
Purchases, sales, issuances, and settlements	(169)	(1,780)	-	965
Foreign currency translation	-	-	-	-
Transfers into Level 3(2)	2,413	13,858	-	-
Transfers out of Level 3(2)	(54)	(746)	-	-
Fair value, end of period	<u>\$2,398</u>	<u>\$25,259</u>	<u>\$576</u>	<u>\$ 16,039</u>
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(3):				
Included in earnings:				
Realized investment gains (losses), net:	\$ (506)	\$ (1,383)	\$ -	\$(43,833)
Asset management fees and other income	\$ -	\$ -	\$ -	\$ -
Interest credited to policyholder account	\$ -	\$ -	\$ -	\$ -
Included in other comprehensive income (loss)	\$ 447	\$ 9,605	\$455	\$ 590

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

### 10. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

	Year Ended December 31, 2009		
	Separate Account Assets(1)	Future Policy Benefits	Other Liabilities
	(in thousands)		
Fair value, beginning of period	\$ 6,494	\$(63,903)	\$(4,272)
Total gains or (losses) (realized/unrealized):			
Included in earnings:			
Realized investment gains (losses), net	-	69,126	4,205
Interest credited to policyholder account	(1,335)	-	-
Included in other comprehensive income	-	-	-
Net investment income	-	-	-
Purchases, sales, issuances, and settlements	38	(2,811)	-
Transfers into Level 3(2)	-	-	-
Transfers out of Level 3(2)	(93)	-	-
Fair value, end of period	<u>\$ 5,104</u>	<u>\$ 2,412</u>	<u>(67)</u>
Unrealized gains(losses) for the period relating to those level 3 assets that were still held at the end of the period (3):			
Included in earnings:			
Realized investment gains (losses), net	\$ -	\$ 68,705	4,208
Interest credited to policyholder account	\$(1,335)	\$ -	-
Included in other comprehensive income	\$ -	\$ -	-

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

**Transfers** – Transfers into Level 3 for Fixed Maturities Available for Sale totaled \$16 million during 2009. Transfers into Level 3 for these investments were primarily the result of unobservable inputs utilized within valuation methodologies and the use of broker quotes (that could not be validated) when information from third party pricing services or models with observable inputs were utilized. Transfers out of Level 3 for Fixed Maturities Available for Sale were primarily due to the use of observable inputs in valuation methodologies as well as the utilization of pricing service information for certain assets that the Company was able to validate.

## Pruco Life Insurance Company of New Jersey

### Notes to Financial Statements

#### 10. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

The following tables provide a summary of the changes in fair value of Level 3 assets and liabilities for the year ended December 31, 2008, as well as the portion of gains or losses included in income for the year ended December 31, 2008, attributable to unrealized gains or losses related to those assets and liabilities still held at December 31, 2008.

	<b>Year Ended December 31, 2008</b>		
	<b>Fixed Maturities, Available For Sale</b>	<b>Equity Securities, Available for Sale</b>	<b>Other Assets</b>
	(in thousands)		
Fair value, beginning of period	\$ 23,659	\$ 2,271	\$ 3,079
Total gains or (losses) (realized/unrealized):	-	-	-
Included in earnings:	-	-	-
Realized investment gains (losses), net	(55)	-	48,957
Interest credited to policyholder account	-	-	-
Included in other comprehensive income (loss)	(3,365)	(422)	(338)
Net investment income	9	-	-
Purchases, sales, issuances, and settlements	2,143	-	758
Foreign currency translation	-	-	-
Transfers into (out of) Level 3 (2)	(16,393)	(1,728)	6,424
Fair value, end of period	<u>\$ 5,998</u>	<u>\$ 121</u>	<u>\$58,880</u>
Unrealized gains (losses) for period relating to those Level 3 assets that were still held by the Company at the end of the period:			
Included in earnings:			
Realized investment gains (losses), net	\$ (32)	\$ -	\$49,013
Interest credited to policyholder account	\$ -	\$ -	\$ -
Included in other comprehensive income (loss)	\$ (1,591)	\$ (327)	\$ (338)

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

### 10. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

	Year Ended December 31, 2008		
	Separate Account Assets(1)	Future Policy Benefits	Other Long- term Investments
	(in thousands)		
Fair value, beginning of period	\$ 7,716	\$ (3,087)	\$ (279)
Total gains or (losses) (realized/unrealized):	-	-	-
Included in earnings:	-	-	-
Realized investment gains (losses), net	-	(59,506)	(3,993)
Interest credited to policyholder account	(1,222)	-	-
Included in other comprehensive income	-	-	-
Net investment income	-	-	-
Purchases, sales, issuances, and settlements	-	(1,309)	-
Transfers into (out of) Level 3 (2)	-	-	-
Fair value, end of period	<u>\$ 6,494</u>	<u>\$ (63,903)</u>	<u>\$ (4,272)</u>
Unrealized gains (losses) for the period relating to those level 3 assets that were still held at the end of the period (3):			
Included in earnings:			
Realized investment gains (losses), net	\$ -	\$ (59,565)	\$ (3,992)
Interest credited to policyholder account	\$ (1,222)	\$ -	\$ -
Included in other comprehensive income	\$ -	\$ -	\$ -

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

**Transfers** – Transfers out of Level 3 for Fixed Maturities Available for Sale totaled \$16.4 million for the year ended December 31, 2008. Transfers into Level 3 for these investments were primarily the result of unobservable inputs utilized within valuation methodologies and the use of broker quotes when information from third party pricing services was utilized. Partially offsetting these transfers into Level 3 were transfers out of Level 3 due to the use of observable inputs in valuation methodologies as well as the utilization of pricing service information for certain assets that the Company was able to validate.

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

### 10. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

**Derivative Fair Value Information** – The following tables presents information regarding derivative assets and liabilities measured at fair value on a recurring basis. The derivative assets are reflected within either “Other long-term investments” on the balance sheet. Derivative liabilities are reflected within “Other liabilities.” These tables exclude embedded derivatives which are recorded with the associated host contract.

	As of December 31, 2010				
	Level 1	Level 2	Level 3	Netting (1)	Total
	(in thousands)				
Derivative assets:					
Interest Rate	\$ -	\$1,738	\$ -	\$ -	\$ 1,738
Currency		-			-
Credit		1,206	-		1,206
Currency/Interest Rate		-			-
Equity		-			-
Netting		-		(2,943)	(2,943)
Total derivative assets	\$ -	\$2,943	\$ -	\$(2,943)	\$ -
Derivative liabilities:					
Interest Rate	\$ -	\$1,006	\$ -	\$ -	\$ 1,006
Currency		-			-
Credit		878	-		878
Currency/Interest Rate		1,957			1,957
Equity		-			-
Netting		-		(2,943)	(3,841)
Total derivative liabilities	\$ -	3,841	-	(2,943)	(898)

- (1) “Netting” amounts represent cash collateral and the impact of offsetting asset and liability positions held with the same counterparty.

**Changes in Level 3 derivative assets and liabilities** – The following tables provide a summary of the changes in fair value of Level 3 derivative assets and liabilities for the year ended December 31, 2010, as well as the portion of gains or losses included in income for the year ended December 31, 2010, attributable to unrealized gains or losses related to those assets and liabilities still held at December 31, 2010.

	Year ended December 31, 2010
	Other Liabilities Derivative Liability – Credit
	(in thousands)
Fair Value, beginning of period	\$(67)
Total gains or (losses) (realized/unrealized):	
Included in earnings:	
Realized investment gains (losses), net	67
Asset management fees and other income	
Purchases, sales, issuances and settlements	
Transfers into Level 3	
Transfers out of Level 3	
Fair Value, end of period	\$ -
Unrealized gains (losses) for the period relating to those level 3 assets that were still held at the end of the period:	
Included in earnings:	
Realized investment gains (losses), net	70
Asset management fees and other income	-

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

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### 10. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

**Fair Value of Financial Instruments** – The Company is required by U.S. GAAP to disclose the fair value of certain financial instruments including those that are not carried at fair value. For the following financial instruments the carrying amount equals or approximates fair value: fixed maturities classified as available for sale, trading account assets, equity securities, securities purchased under agreements to resell, short-term investments, cash and cash equivalents, accrued investment income, separate account assets, securities sold under agreements to repurchase, and cash collateral for loaned securities, as well as certain items recorded within other assets and other liabilities such as broker-dealer related receivables and payables. See Note 5 for a discussion of derivative instruments.

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

	<u>December 31, 2010</u>		<u>December 31, 2009</u>	
	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Fair Value</u>
	(in thousands)			
<b>Assets:</b>				
Commercial mortgage loans	\$182,437	\$192,102	\$167,935	\$167,883
Policy loans	175,514	211,513	169,835	191,499
<b>Liabilities:</b>				
Policyholder account balances – Investment contracts	102,593	101,551	85,661	84,336

#### ***Commercial Mortgage Loans***

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

#### ***Policy Loans***

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

#### ***Investment Contracts – Policyholders' Account Balances***

Only the portion of policyholders' account balances related to products that are investment contracts (those without significant mortality or morbidity risk) are reflected in the table above. For payout annuities and other similar contracts without life contingencies, fair values are derived using discounted projected cash flows based on interest rates that are representative of the Company's financial strength ratings, and hence reflect the Company's own non-performance risk. For those balances that can be withdrawn by the customer at any time without prior notice or penalty, the fair value is the amount estimated to be payable to the customer as of the reporting date, which is generally the carrying value.

### 11. DERIVATIVE INSTRUMENTS

#### **Types of Derivative Instruments and Derivative Strategies**

Interest rate swaps are used by the Company to manage interest rate exposures arising from mismatches between assets and liabilities (including duration mismatches) and to hedge against changes in the value of assets it anticipates acquiring and other anticipated transactions and commitments. Swaps may be attributed to specific

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

### 11. DERIVATIVE INSTRUMENTS (continued)

assets or liabilities or may be used on a portfolio basis. Under interest rate swaps, the Company agrees with other parties to exchange, at specified intervals, the difference between fixed rate and floating rate interest amounts calculated by reference to an agreed upon notional principal amount. Generally, no cash is exchanged at the outset of the contract and no principal payments are made by either party. These transactions are entered into pursuant to master agreements that provide for a single net payment to be made by one counterparty at each due date.

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

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

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

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

	December 31, 2010			December 31, 2009		
	Notional Amount	Fair Value		Notional Amount	Fair Value	
		Assets	Liabilities		Assets	Liabilities
<b>Qualifying Hedge Relationships</b>		(in thousands)			(in thousands)	
Currency/Interest Rate	\$ 11,018	\$ -	(1,104)	\$ 5,366	\$ -	\$ (678)
<b>Total Qualifying Hedge Relationships</b>	<u>\$ 11,018</u>	<u>\$ -</u>	<u>\$ (1,104)</u>	<u>\$ 5,366</u>	<u>\$ -</u>	<u>\$ (678)</u>
<b>Non-qualifying Hedge Relationships</b>						
Interest Rate	\$47,000	\$1,737	\$(1,006)	\$94,000	\$ 191	\$(4,766)
Credit	\$ 8,900	\$1,206	\$( 878)	\$21,950	\$3,730	\$(1,065)
Currency/Interest Rate	\$ 9,115	\$ -	\$( 853)	\$20,015	\$ -	\$( 921)
<b>Total Non-qualifying Hedge Relationships</b>	<u>\$ 65,015</u>	<u>\$ 2,943</u>	<u>\$ (2,737)</u>	<u>\$135,965</u>	<u>\$ 3,921</u>	<u>\$ (6,752)</u>
<b>Total Derivatives</b>	<u>\$ 76,033</u>	<u>\$ 2,943</u>	<u>\$ (3,841)</u>	<u>\$141,331</u>	<u>\$ 3,921</u>	<u>\$ (7,430)</u>

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

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### 11. DERIVATIVE INSTRUMENTS (continued)

#### *Embedded Derivatives*

The Company holds certain externally managed investments in the European market which contain embedded derivatives whose fair value are primarily driven by changes in credit spreads. These investments are medium term notes that are collateralized by investment portfolios primarily consisting of investment grade European fixed income securities, including corporate bonds and asset-backed securities, and derivatives, as well as varying degrees of leverage. The notes have a stated coupon and provide a return based on the performance of the underlying portfolios and the level of leverage. The Company invests in these notes to earn a coupon through maturity, consistent with its investment purpose for other debt securities. The notes are accounted for under U.S. GAAP as available for sale fixed maturity securities with bifurcated embedded derivatives (total return swaps). Changes in the value of the fixed maturity securities are reported in Equity under the heading "Accumulated Other Comprehensive Income" and changes in the market value of the embedded total return swaps are included in current period earnings in "Realized investment gains (losses), net." The Company's maximum exposure to loss from these interests was \$7 million at December 31, 2010 and December 31, 2009. The fair value of the embedded derivatives included in Fixed maturities, available for sale was a liability of \$3 million at December 31, 2010 and December 31, 2009.

The fair value of the embedded derivatives included in Future policy benefits was an asset of \$41 million as of December 31, 2010 and an asset of \$2 million as of December 31, 2009 included in Future policy benefits.

The Company also incorporates risk of non-performance of its affiliates in the valuation of the embedded derivatives associated with our living benefit features on our variable annuity contracts and the no lapse feature of our universal life contracts. We include an additional spread over LIBOR into the discount rate used in the valuation of the embedded derivative liabilities to reflect an increase in market perceived non-performance risk, thereby reducing the value of the embedded derivative assets. The non-performance cannot reduce the value of the liability to a point that the value would go below zero. In that case the value of the liability is floored at zero.

Some of the Company's variable annuity products contain a living benefit feature which is reinsured with an affiliate, Pruco Re. The reinsurance contract contains an embedded derivative related to market performance risk. These embedded derivatives are mark-to-market through "Realized investment gains (losses), net" based on the change in value of the underlying contractual guarantees, which are determined using valuation models. The affiliates maintain a portfolio of derivative instruments that are intended to economically hedge the risks related to the reinsured products' features. The derivatives may include, but are not limited to equity options, total return swaps, interest rate swap options, caps, floors, and other instruments. Also, some variable annuity products include an asset transfer feature, to minimize risks inherent in the Company's guarantees which reduce the need for hedges. In addition to the hedging of guaranteed risks by Pruco Re. the Company started hedging a portion of the market exposure related to the overall capital position of its variable annuity products.

#### *Cash Flow Hedges*

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

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

### 11. DERIVATIVE INSTRUMENTS (continued)

The following table provides the financial statement classification and impact of derivatives used in qualifying and non-qualifying hedge relationships, excluding the offset of the hedged item in an effective hedge relationship:

	<b>Year Ended December 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
	(in thousands)		
<b>Cash flow hedges</b>			
<i>Currency/ Interest Rate</i>			
Net investment income	\$ 45	\$ 3	\$ -
Other Income	2	(12)	(5)
Accumulated Other Comprehensive Income (Loss) (1)	<u>\$ (426)</u>	<u>\$ (711)</u>	<u>\$ -</u>
Total cash flow hedges	<u>\$ (379)</u>	<u>\$ (720)</u>	<u>\$ (5)</u>
<b>Non- qualifying hedges</b>			
Realized investment gains (losses)			
Interest Rate	\$ 6,717	\$ (6,086)	\$ (261)
Currency/Interest Rate	617	(880)	156
Credit	(762)	2,763	(1,193)
Embedded Derivatives	<u>47,806</u>	<u>26,471</u>	<u>(14,198)</u>
Total non-qualifying hedges	<u>\$54,378</u>	<u>\$22,268</u>	<u>\$(15,496)</u>
<b>Total Derivative Impact</b>	<u>\$53,999</u>	<u>\$21,548</u>	<u>\$(15,501)</u>

For the year ended December 31, 2010, the ineffective portion of derivatives accounted for using hedge accounting was not material to the Company's results of operations and there were no material amounts reclassified into earnings relating to instances in which the Company discontinued cash flow hedge accounting because the forecasted transaction did not occur by the anticipated date or within the additional time period permitted by the authoritative guidance for the accounting for derivatives and hedging.

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

	<b>(in thousands)</b>
Balance, December 31, 2009	\$ (675)
Net deferred losses on cash flow hedges from January 1 to December 31, 2010	(373)
Amount reclassified into current period earnings	<u>(52)</u>
Balance, December 31, 2010	<u>\$(1,100)</u>

As of December 31, 2010, the Company does not have any qualifying cash flow hedges of forecasted transactions other than those related to the variability of the payment or receipt of interest or foreign currency amounts on existing financial instruments. The maximum length of time for which these variable cash flows are hedged is 7 years. Income amounts deferred in "Accumulated other comprehensive income (loss)" as a result of cash flow hedges are included in "Net unrealized investment gains (losses)" in the Statements of Stockholders' Equity.

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

### 11. DERIVATIVE INSTRUMENTS (continued)

#### *Credit Derivatives Written*

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

NAIC Designation(1)	December 31, 2010	
	First to default Basket(1)	
	Notional	Fair Value
	(in millions)	
1	\$ -	\$ -
2	-	-
3	-	-
4	-	-
5	-	-
6	-	-
Total	\$ -	\$ -

NAIC Designation(1)	December 31, 2009	
	First to Default Basket(1)	
	Notional	Fair Value
	(in millions)	
1	\$ -	\$ -
2	9	-
3	-	-
4	-	-
5	-	-
6	-	-
Total	\$ 9	\$ -

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

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

Industry	December 31, 2010		December 31, 2009	
	Notional	Fair Value	Notional	Fair Value
	(in millions)			
Corporate Securities:				
First to Default Baskets(1)	\$ -	\$ -	\$ 9	\$ -
Total Credit Derivatives	\$ -	\$ -	\$ 9	\$ -

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

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

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### 11. DERIVATIVE INSTRUMENTS (continued)

The Company writes credit derivatives under which the Company is obligated to pay the counterparty the referenced amount of the contract and receive in return the defaulted security or similar security. The Company's maximum amount at risk under these credit derivatives, assuming the value of the underlying referenced securities become worthless, is \$0 million and \$9 million notional of credit default swap ("CDS") selling protection at December 31, 2010 and December 31, 2009, respectively. These credit derivatives generally have maturities of five years or less.

In addition to writing credit protection, the Company has purchased credit protection using credit derivatives in order to hedge specific credit exposures in the Company's investment portfolio. As of December 31, 2010 the Company had \$9 million of outstanding notional amounts, reported at fair value as an asset of \$0.3 million. At December 31, 2009, the Company had \$13 million of outstanding notional amounts, reported at fair value as an asset of \$3 million.

#### *Credit Risk*

The Company is exposed to credit-related losses in the event of non-performance by our counterparty to financial derivative transactions. Generally, the credit exposure of the Company's over-the-counter (OTC) derivative transactions is represented by the contracts with a positive fair value (market value) at the reporting date after taking into consideration the existence of netting agreements.

### 12. COMMITMENTS, CONTINGENT LIABILITIES AND LITIGATION AND REGULATORY MATTERS

#### *Commitments*

The Company has made commitments to fund \$8 million of commercial loans as of December 31, 2010. The Company also made commitments to purchase or fund investments, mostly private fixed maturities, of \$15 million as of December 31, 2010.

#### *Contingent Liabilities*

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

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

#### *Litigation and Regulatory Matters*

The Company is subject to legal and regulatory actions in the ordinary course of its business. Pending legal and regulatory actions include proceedings relating to aspects of the Company's business and operations that are specific to it and proceedings that are typical of the business in which it operates. In certain of these matters, the plaintiffs may seek large and/or indeterminate amounts, including punitive or exemplary damages. The outcome of a litigation or regulatory matter, and the amount or range of potential loss at any particular time, is often inherently uncertain.

# **Pruco Life Insurance Company of New Jersey**

## **Notes to Financial Statements**

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### **12. COMMITMENTS, CONTINGENT LIABILITIES AND LITIGATION AND REGULATORY MATTERS (continued)**

In July 2010, the Company and certain affiliates, as well as other life insurance industry participants, received a formal request for information from the State of New York Attorney General's Office in connection with its investigation into industry practices relating to life insurance policies for which death benefits, unless the beneficiary elects another settlement method, are placed in retained asset accounts, which earn interest and are subject to withdrawal in whole or in part at any time by the beneficiary. The Company is cooperating with this investigation. The Company has also been contacted by state insurance regulators and other governmental entities regarding retained asset accounts. In April 2010, a purported state-wide class action was filed against Prudential Insurance in Nevada state court alleging that Prudential Insurance delayed payment of death benefits and improperly retained undisclosed profits by placing death benefits in retained asset accounts. In January 2011, this action was dismissed. In February 2011, the plaintiff appealed the dismissal. An earlier case by the same plaintiff making substantially the same allegations was dismissed in federal court. In December 2010, a purported state-wide class action was filed in state court against Prudential Insurance and Prudential Financial and removed to federal court in Illinois. The complaint makes allegations under Illinois law substantially similar to the other retained asset account cases on behalf of a class of Illinois residents.

In July 2010, a purported nationwide class action was filed in Massachusetts federal court against Prudential Insurance relating to retained asset accounts associated with life insurance covering U.S. service members and veterans. The Company has moved to dismiss the complaint. In November and December 2010, three additional purported class actions making substantially the same allegations on behalf of the same purported class of beneficiaries were filed against Prudential Insurance and Prudential Financial in New Jersey federal court and were transferred to the Massachusetts federal court by the Judicial Panel on Multi-District Litigation. In October 2010, a purported nationwide class action was filed in Pennsylvania federal court on behalf of beneficiaries of ERISA-governed welfare benefit plans claiming that the use of retained asset accounts violates ERISA. Additional investigations, information requests, hearings, claims, litigation and adverse publicity may arise with respect to the retained asset accounts.

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

### **13. RELATED PARTY TRANSACTIONS**

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

#### ***Expense Charges and Allocations***

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

## **Pruco Life Insurance Company of New Jersey**

### **Notes to Financial Statements**

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#### **13. RELATED PARTY TRANSACTIONS (continued)**

The Company's general and administrative expenses are charged to the Company using allocation methodologies based on business processes. Management believes that the methodology is reasonable and reflects costs incurred by Prudential Insurance to process transactions on behalf of the Company. The Company operates under service and lease agreements whereby services of officers and employees, supplies, use of equipment and office space are provided by Prudential Insurance. The Company reviews its allocation methodology periodically which it may adjust accordingly. General and administrative expenses include allocations of stock compensation expenses related to a stock option program and a deferred compensation program issued by Prudential Financial. The expense charged to the Company for the stock option program was less than \$0.1 million for the twelve months ended December 31, 2010, 2009 and 2008. The expense charged to the Company for the deferred compensation program was \$0.5 million, \$0.3 million and \$0.2 million for the twelve months ended December 31, 2010, 2009 and 2008, respectively.

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

Prudential Insurance sponsors voluntary savings plans for the Company's expenses for its share of the voluntary savings plan (401(k) plans). The plans provide for salary reduction contributions by employees and matching contributions by the Company of up to 4% of annual salary. The Company's expense for its share of the voluntary savings plan was \$0.7 million in 2010 and \$0.5 million in 2009 and 2008, respectively.

The Company's share of net expense for the pension plans was \$1.3 million in 2010 and \$1 million in 2009 and 2008, respectively.

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

#### ***Affiliated Asset Administration Fee Income***

Effective April 15, 2009, the Company amended an existing agreement to add AST Investment Services, Inc., formerly known as American Skandia Investment Services, Inc, as a party whereas the Company receives fee income calculated on contractholder separate account balances invested in the Advanced Series Trust, formerly known as American Skandia Trust. Income received from AST Investment Services, Inc. related to this agreement was \$3.7 million and \$1.1 million for the years ended December 31, 2010 and 2009, respectively. These revenues are recorded as "Asset administration fees" in the Statements of Operations and Comprehensive Income.

Beginning October 1, 2002, in accordance with a servicing agreement with Prudential Investments LLC, the Company receives fee income from policyholder account balances invested in the Prudential Series Fund ("PSF"). Income received from Prudential Investments LLC, related to this agreement was \$6 million and \$5 million for the years ended December 31, 2010 and 2009, respectively. These revenues are recorded as "Asset administration fees" in the Statements of Operations and Comprehensive Income.

## **Pruco Life Insurance Company of New Jersey**

### **Notes to Financial Statements**

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#### **13. RELATED PARTY TRANSACTIONS (continued)**

##### ***Corporate Owned Life Insurance***

The Company has sold two Corporate Owned Life Insurance, or “COLI”, policies to Prudential Insurance and one to Prudential Financial. The cash surrender value included in separate accounts for these COLI policies was \$1 billion and \$853 million at December 31, 2010 and December 31, 2009, respectively. Fees collected related to these COLI policies were \$25 million, \$23 million and \$19 million for the years ending December 31, 2010, 2009 and 2008, respectively.

##### ***Reinsurance with Affiliates***

###### **Pruco Life**

Effective April 1, 2008, the Company entered into an agreement to reinsure certain variable COLI policies with Pruco Life. Reinsurance recoverables related to this agreement were \$5 million as of December 31, 2010, and \$2 million as of December 31, 2009. Fees ceded to Pruco Life were \$11 million, \$6 million, and \$3 million for the years ended December 31, 2010, 2009 and 2008, respectively. Benefits ceded were \$1 million, \$2 million and \$3 million for the years ended December 31, 2010, 2009 and 2008, respectively. The Company is not relieved of its primary obligation to the policyholder as a result of this agreement.

###### **PARCC**

The Company reinsures 90% of the risks under its term life insurance policies, written prior to January 1, 2010, through an automatic coinsurance agreement with PARCC. The Company is not relieved of its primary obligation to the policyholder as a result of this agreement. Reinsurance recoverables related to this agreement were \$360 million and \$303 million as of December 31, 2010 and December 31, 2009, respectively. Premiums ceded to PARCC in 2010, 2009 and 2008 were \$134 million, \$140 million and \$127 million, respectively. Benefits ceded in 2010, 2009 and 2008 were \$53 million each year, respectively. Reinsurance expense allowances, net of capitalization and amortization were \$29 million, \$31 million and \$26 million for the years ended December 31, 2010, 2009 and 2008, respectively. The Company is not relieved of its primary obligation to the policyholder as a result of this agreement.

###### **PAR TERM**

The Company reinsures 95% of the risks under its term life insurance policies issued on or after January 1, 2010, through an automatic coinsurance agreement with PAR TERM. The Company is not relieved of its primary obligation to the policyholder as a result of this agreement. Reinsurance recoverables related to this agreement were \$10 million as of December 31, 2010. Premiums ceded to PAR TERM in 2010 were \$11 million. Benefits ceded in 2010 were \$656 million.

Reinsurance expense allowances, net of capitalization and amortization were \$2 million for the year ended December 31, 2010

###### **Prudential Insurance**

The Company has a yearly renewable term reinsurance agreement with Prudential Insurance and reinsures the majority of all mortality risks not otherwise reinsured. The reinsurance recoverables related to this agreement were \$32 million and \$7 million as of December 31, 2010 and December 31, 2009, respectively. Premiums and fees ceded to Prudential Insurance in 2010, 2009 and 2008 were \$58 million, \$33 million and \$35 million, respectively. Benefits ceded in 2010, 2009 and 2008 were \$40 million and \$29 million and \$28 million, respectively. The Company is not relieved of its primary obligation to the policyholder as a result of this agreement.

## **Pruco Life Insurance Company of New Jersey**

### **Notes to Financial Statements**

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#### **13. RELATED PARTY TRANSACTIONS (continued)**

##### **Pruco Re**

The Company has entered into reinsurance agreements with Pruco Re as part of its risk management and capital management strategies.

Since 2005 the Company reinsures 100% of the risk on its Lifetime Five benefit feature sold on certain of its annuities through an automatic coinsurance agreement with Pruco Re. Fees ceded on this agreement, included in "Realized investment gains/(losses), net" on the financial statements, were \$1 million and \$1 million for December 31, 2010 and December 31, 2009, respectively.

Since 2005 the Company reinsures 100% of the risk on its Spousal Lifetime Five benefit feature. Fees ceded on this agreement, included in "Realized investment gains/(losses), net" on the financial statements, were \$0.2 million and \$0.1 million December 31, 2010 and December 31, 2009, respectively.

The Company's reinsurance recoverables related to the above product reinsurance agreements were \$11 million and \$10 million as of December 31, 2010 and December 31, 2009, respectively. Realized losses ceded were (\$0.4) million and (\$44.4) million for the years ended December 31, 2010 and December 31, 2009, respectively.

##### ***Affiliated Asset Transfers***

The Company buys and sells assets to and from affiliated companies. These transactions are recorded in accordance with the Company's policy, which results in the difference between fair market value and book value of these transfers being accounted for in additional paid-in capital.

In December 2010, the Company amended certain of its affiliated reinsurance treaties to change the settlement mode from monthly to annual. As a result of these treaty amendments, we were required to pay our reinsurers, Prudential Insurance and UPARC, the premium difference that resulted. Settlement of this premium difference was made by transfers of securities of \$20 million to Prudential Insurance, and \$3 million to Pruco Life Insurance Company of Arizona. The difference between fair market value and book value of these transfers was accounted for in additional paid-in capital.

##### ***Debt Agreements***

The Company and its parent, Pruco Life, have an agreement with Prudential Funding, LLC, which allows it to borrow funds for working capital and liquidity needs. The borrowings under this agreement are limited to \$200 million. The Company had no debt outstanding to Prudential Funding, LLC as of December 31, 2010 and 2009. Interest expense related to this debt was less than \$1 million as of December 31, 2010 and December 31, 2009. Interest expense was charged at a variable rate ranging from 2.85% to 4.15% for 2010 and 3.55% to 7.05% for 2009.

##### ***Derivative Trades***

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

# Pruco Life Insurance Company of New Jersey

## Notes to Financial Statements

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### 14. QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The unaudited quarterly results of operations for the years ended December 31, 2010 and 2009 are summarized in the table below:

	Three months ended			
	<u>March 31</u>	<u>June 30</u>	<u>September 30</u>	<u>December 31</u>
	(in thousands)			
<b><u>2010</u></b>				
Total revenues	\$ 53,550	\$ 39,035	\$51,665	\$73,986
Total benefits and expenses	30,833	55,987	(1,355)	(8,715)
Income/(Loss) from operations before income taxes	22,717	(16,952)	53,020	82,701
Net income (loss)	<u>\$ 16,552</u>	<u>\$(11,901)</u>	<u>\$39,119</u>	<u>54,174</u>
<b><u>2009</u></b>				
Total revenues	\$ 44,450	\$ 36,244	\$41,742	\$59,181
Total benefits and expenses	58,750	6,029	11,762	29,047
Income/(Loss) from operations before income taxes	(14,300)	30,215	29,980	30,134
Net income (loss)	<u>(11,367)</u>	<u>\$ 23,617</u>	<u>26,754</u>	<u>\$16,019</u>

## **Management's Annual Report on Internal Control Over Financial Reporting**

Management of Pruco Life Insurance Company of New Jersey ("the Company") is responsible for establishing and maintaining adequate internal control over financial reporting. Management conducted an assessment of the effectiveness, as of December 31, 2010, of the Company's internal control over financial reporting, based on the framework established in Internal Control – Integrated Framework Issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on our assessment under that framework, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2010.

Our internal control over financial reporting is a process designed by or under the supervision of our principal executive and principal financial officers to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of management and the directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on our financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

This Annual Report does not include an attestation report of the Company's registered public accounting firm, PricewaterhouseCoopers LLP, regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to final rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this Annual Report.

March 11, 2011

## **Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholder of  
Pruco Life Insurance Company of New Jersey:

In our opinion, the accompanying statements of financial position and the related statements of operations and comprehensive income, of stockholder's equity and of cash flows present fairly, in all material respects, the financial position of Pruco Life Insurance Company of New Jersey (an indirect, wholly owned subsidiary of The Prudential Insurance Company of America) at December 31, 2010 and December 31, 2009, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2010 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 2 of the financial statements, the Company changed its method of determining and recording other-than-temporary impairment for debt securities on January 1, 2009.

/s/ PricewaterhouseCoopers LLP  
New York, New York  
March 11, 2011