NEWS RELEASE

13 March 2019

PRUDENTIAL PLC FULL YEAR 2018 RESULTS

PRUDENTIAL DELIVERS CONTINUED GROWTH IN PROFIT AND DIVIDEND

Performance highlights on a constant (and actual) exchange rate basis

- Group operating profit[1] of £4,827 million, up 6 per cent[2] (up 3 per cent[3])
- Asia EEV new business profit[4] of £2,604 million, up 14 per cent[2], operating profit[1] of £2,164 million, up 14 per cent[2] and underlying free surplus generation[5] of £1,171 million, up 14 per cent[2]
- US fee income up 8 per cent[2] following a 10 per cent[2] increase in average separate account balances[6]
- M&GPrudential operating profit[1] up 19 per cent, including the effect of updated longevity assumptions
- Full year 2018 ordinary dividend increased by 5 per cent to 49.35 pence per share
- Group Solvency II surplus[7,8] estimated at £17.2 billion, equivalent to a cover ratio of 232 per cent
- Continued progress in preparations for the demerger of M&GPrudential from Prudential plc

Mike Wells, Group Chief Executive, said: 'In 2018, our financial performance, again led by our Asia operations, is testament to the scale of our opportunity set, the depth of our capabilities and our unrelenting focus on executing our strategy at pace. At the same time we have made good progress in our preparations for the demerger of M&GPrudential from Prudential plc.

'In Asia we have again delivered double-digit growth across our key metrics of new business profit[4] (up 14 per cent[2]), operating profit[1] (up 14 per cent[2]) and underlying free surplus generation[5] (up 14 per cent[2]). This performance is both broad-based, with 10 markets achieving double-digit growth[2] in new business profit[4], and high-quality, with health and protection new business profit growing by 15 per cent[2]. Our Asia asset manager, Eastspring, has increased operating profit (up 6 per cent[2]) amidst a challenging external environment reflecting the structural benefit from life business net flows. Our broad-based portfolio of life insurance and asset management businesses, high-quality products with distinctive value-added services and multi-channel strategy ensure that we continue to benefit from the growing customer demand in Asia for the health, protection and savings solutions that we provide.

'In the US, our life business, Jackson, remains focused on providing financial security to increasing numbers of individuals approaching or in retirement, broadening its product range and extending its distribution network. US operating profit decreased by 11 per cent, with higher fee income being more than offset by higher market-related amortisation of acquisition costs and lower spread-based income. Jackson's risk-based capital ratio, which increased from 409 per cent to 458 per cent by year-end, highlights the effectiveness of its risk management and hedging performance in the equity market decline experienced during the fourth quarter.

'M&GPrudential continues to make progress implementing its merger and transformation programme while consolidating its position as one of the leading businesses in the UK & European savings and investment markets. M&GPrudential's total operating profit increased 19 per cent, principally reflecting the benefit from updated longevity assumptions and an 11 per cent increase in the shareholder transfer from the with-profits business, which includes a 30 per cent increase from PruFund.

'The intended demerger of M&GPrudential from Prudential plc will further enhance the strategic focus of both businesses. I am confident that, given the extent of our opportunities and our proven ability to execute and innovate, we are well positioned to continue to grow profitably.'

Summary financials	**2018 £m**	**2017 £m**	**Change on AER basis**	**Change on CER basis**
Operating profit[1]	**4,827**	4,699	3%	6%
Underlying free surplus generated[5]	**4,047**	3,640	11%	14%
Life new business profit[4]	**3,877**	3,616	7%	11%
IFRS profit after tax[9]	**3,013**	2,390	26%	30%
Net cash remittances from business units[10]	**1,732**	1,788	(3)%	-

	2018 £bn	**2017 £bn**	**Change on AER basis**
IFRS shareholders' funds	**17.2**	16.1	7%
EEV shareholders' funds	**49.8**	44.7	11%
Group Solvency II capital surplus[7,8]	**17.2**	13.3	29%

Notes

1 In this press release 'operating profit' refers to adjusted IFRS operating profit based on longer-term investment returns. This alternative performance measure is reconciled to IFRS profit for the year in note B1.1 of the IFRS financial statements.
2 Year-on-year percentage increases are stated on a constant exchange rate basis unless otherwise stated.
3 Growth rate on an actual exchange rate basis.
4 New business profit on business sold in the year, calculated in accordance with EEV principles.
5 For insurance operations, underlying free surplus generated represents amounts maturing from the in-force business during the period less investment in new business and excludes non-operating items. For asset management businesses, it equates to post-tax operating profit for the period. Restructuring costs are presented separately from the underlying business unit amount. Further information is set out in note 10 of the EEV basis results.
6 Average US separate account balances for the year to 31 December 2018, compared to average balances for the year to 31 December 2017 on a constant exchange rate basis.
7 The Group shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring fenced with-profit funds and staff pension schemes in surplus. The estimated solvency positions include management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date, which for both 2018 and 2017 reflects the approved regulatory position.
8 Estimated before allowing for second interim ordinary dividend.
9 IFRS profit after tax reflects the combined effects of operating results determined on the basis of longer-term investment returns, together with short-term investment variances, results attaching to disposal of businesses and corporate transactions, amortisation of acquisition accounting adjustments and the total tax charge for the year.
10 Net cash remitted by business units are included in the Holding company cash flow, which is disclosed in detail in note II(a) of the Additional unaudited IFRS financial information. This comprises dividends and other transfers from business units that are reflective of emerging earnings and capital generation.

Contact:

Media		**Investors/Analysts**	
Jonathan Oliver	+44 (0)20 7548 3537	Chantal Waight	+44 (0)20 7548 3039
Tom Willetts	+44 (0)20 7548 2776	Richard Gradidge	+44 (0)20 7548 3860
		William Elderkin	+44 (0)20 3480 5590

Notes to Editors:

a. The results in this announcement are prepared on two bases: International Financial Reporting Standards (IFRS) and European Embedded Value (EEV). The results prepared under IFRS form the basis of the Group's statutory financial statements. The supplementary EEV basis results have been prepared in accordance with the amended European Embedded Value Principles dated April 2016 prepared by the European Insurance CFO Forum. The Group's EEV basis results are stated on a post-tax basis and include the post-tax IFRS basis results of the Group's asset management and other operations. Year-on-year percentage increases are stated on a constant exchange rate basis unless otherwise stated. Constant exchange rates are calculated b translating prior year results using the current period foreign exchange rate ie current period average rates for the income statement and current period closing rates for the balance sheet.

b. Adjusted IFRS operating profit based on longer-term investment returns is determined on the basis of including longer-term investment returns. EEV and adjusted IFRS operating profit based on longer-term investment returns is stated after excluding the effect of short-term fluctuations in investment returns against long-term assumptions and gains/losses arising on the disposal of businesses and other corporate transactions including the reinsurance of UK annuity contracts to Rothesay Life in March 2018. Furthermore, for EEV basis results, operating profit based on longer-term investment returns excludes the effect of changes in economic assumptions and the mark to market value movement on core borrowings. Separately on the IFRS basis, operating profit also excludes amortisation of accounting adjustments arising principally on the acquisition of REALIC completed in 2012.

c. Total number of Prudential plc shares in issue as at 31 December 2018 was 2,593,044,409.

d. A presentation for analysts and investors will be held today at 11.30am (UK time) / 7.30pm (Hong Kong time) in the conference suite at Nomura, 1 Angel Lane, London EC4R 3AB. The presentation will be webcast live and available to replay afterwards using the following link https://www.investis-live.com/prudential/5c73c9a8cad1ac0c00430540/2018-full-year-results

To register attendance in person please send an email to investor.relations@prudential.co.uk

Alternatively, a dial-in facility will be available to listen to the presentation: please allow time ahead of the presentation to join the call (lines open half an hour before the presentation is due to start, ie from 11.00am (UK time) / 7.00pm (Hong Kong time).

Dial-in: 020 3936 2999 (UK Local Call) / +44 20 3936 2999 (International) / 0800 640 6441 (Freephone UK), Participant access code: 082125. Once participants have entered this code their name and company details will be taken.

Playback: +44 (0) 20 3936 3001 (UK and international excluding US) / + 1 845 709 8569 (US only) (Replay code: 275563). This will be available from approximately 3.00pm (UK time) / 11.00pm (Hong Kong time) on 13 March 2019 until 11.59pm (UK time) on 27 March 2019 / 7.59am (Hong Kong time) on 28 March 2019.

e. 2018 Second interim ordinary dividend

Ex-dividend date	28 March 2019 (UK, Ireland, Hong Kong and Singapore)
Record date	29 March 2019
Payment of dividend	17 May 2019 (UK, Ireland and Hong Kong) On or about 24 May 2019 (Singapore and ADR holders)

f. About Prudential plc

Prudential plc and its affiliated companies constitute one of the world's leading financial services groups, serving 26 million customers and it has £657 billion of assets under management (as at 31 December 2018). Prudential plc is incorporated in England and Wales and is listed on the stock exchanges in London, Hong Kong, Singapore and New York. Prudential plc is not affiliated in any manner with Prudential Financial, Inc., a company whose principal place of business is in the United States of America.

g. Forward-Looking Statements

This document may contain 'forward-looking statements' with respect to certain of Prudential's plans and its goals and expectations relating to its future financial condition, performance, results, strategy and objectives. Statements that are not historical facts, including statements about Prudential's beliefs and expectations and including, without limitation, statements containing the words 'may', 'will', 'should', 'continue', 'aims', 'estimates', 'projects', 'believes', 'intends', 'expects', 'plans', 'seeks' and 'anticipates', and words of similar meaning, are forward-looking statements. These statements are based on plans, estimates and projections as at the time they are made, and therefore undue reliance should not be placed on them. By their nature, all forward-looking statements involve risk and uncertainty. A number of important factors could cause Prudential's actual future financial condition or performance or other indicated results to differ materially from those indicated in any forward-looking statement. Such factors include, but are not limited to, the timing, costs and successful implementation of the demerger of the M&GPrudential business; the future trading value of the shares of Prudential plc and the trading value and liquidity of the shares of the to-be-listed M&GPrudential business following such demerger; future market conditions, including fluctuations in interest rates and exchange rates, the potential for a sustained low-interest rate environment, and the performance of financial markets generally; the policies and actions of regulatory authorities, including, for example, new government initiatives; the political, legal and economic effects of the UK's decision to leave the European Union; the impact of continuing designation as a Global Systemically Important Insurer or 'G-SII'; the impact of competition, economic uncertainty, inflation and deflation; the effect on Prudential's business and results from, in particular, mortality and morbidity trends, lapse rates and policy renewal rates; the timing, impact and other uncertainties of future acquisitions or combinations within relevant industries; the impact of internal projects and other strategic actions failing to meet their objectives; disruption to the availability, confidentiality or integrity of Prudential's IT systems (or those of its suppliers); the impact of changes in capital, solvency standards, accounting standards or relevant regulatory frameworks, and tax and other legislation and regulations in the jurisdictions in which Prudential and its affiliates operate; and the impact of legal and regulatory actions, investigations and disputes. These and other important factors may, for example, result in changes to assumptions used for determining results of operations or re-estimations of reserves for future policy benefits. Further discussion of these and other important factors that could cause Prudential's actual future financial condition or performance or other indicated results to differ, possibly materially, from those anticipated in Prudential's forward-looking statements can be found under the 'Risk Factors' section in this document.

Any forward-looking statements contained in this document speak only as of the date on which they are made. Prudential expressly disclaims any obligation to update any of the forward-looking statements contained in this document or any other forward-looking statements it may make, whether as a result of future events, new information or otherwise except as required pursuant to the UK Prospectus Rules, the UK Listing Rules, the UK Disclosure and Transparency Rules, the Hong Kong Listing Rules, the SGX-ST listing rules or other applicable laws and regulations.

Summary 2018 financial performance

Financial highlights

Life APE new business sales (APE sales)[1]

	Actual exchange rate			Constant exchange rate	
	2018 £m	**2017 £m**	**Change %**	**2017 £m**	**Change %**
Asia	**3,744**	3,805	(2)	3,671	2
US	**1,542**	1,662	(7)	1,605	(4)
UK and Europe	**1,516**	1,491	2	1,491	2
Total Group	**6,802**	6,958	(2)	6,767	1

Life EEV new business profit and investment in new business

	Actual exchange rate						Constant exchange rate			
	2018 £m		**2017 £m**		**Change %**		**2017 £m**		**Change %**	
	New Business Profit	**Free surplus invested in new business**	**New Business Profit**	**Free surplus invested in new business**	**New Business Profit**	**Free surplus invested in new business**	**New Business Profit**	**Free surplus invested in new business**	**New Business Profit**	**Free surplus invested in new business**
Asia	**2,604**	**488**	2,368	484	10	1	2,282	466	14	5
US	**921**	**225**	906	254	2	(11)	874	245	5	(8)
UK and Europe	**352**	**102**	342	175	3	(42)	342	175	3	(42)
Total Group	**3,877**	**815**	3,616	913	7	(11)	3,498	886	11	(8)

IFRS profit[2]

	Actual exchange rate			Constant exchange rate	
	2018 £m	**2017 £m**	**Change %**	**2017 £m**	**Change %**
Operating profit before tax based on longer-term investment returns					
Asia					
Long-term business	**1,982**	1,799	10	1,727	15
Asset management	**182**	176	3	171	6
Total	**2,164**	1,975	10	1,898	14
US					
Long-term business	**1,911**	2,214	(14)	2,137	(11)
Asset management	**8**	10	(20)	9	(11)
Total	**1,919**	2,224	(14)	2,146	(11)
UK and Europe					
Long-term business	**1,138**	861	32	861	32
General insurance commission	**19**	17	12	17	12
Total insurance operations	**1,157**	878	32	878	32
Asset management	**477**	500	(5)	500	(5)
Total	**1,634**	1,378	19	1,378	19
Other income and expenditure	**(725)**	(775)	6	(769)	6
Total operating profit based on longer-term investment returns before tax and restructuring costs	**4,992**	4,802	4	4,653	7
Restructuring costs[3]	**(165)**	(103)	(60)	(103)	(60)
Total operating profit based on longer-term investment returns before tax	**4,827**	4,699	3	4,550	6
Non-operating items:					
Short-term fluctuations in investment returns on shareholder-backed business	**(558)**	(1,563)	64	(1,514)	63
Amortisation of acquisition accounting adjustments	**(46)**	(63)	27	(61)	25
(Loss) gain on disposal of businesses and corporate transactions	**(588)**	223	n/a	218	n/a
Profit before tax	**3,635**	3,296	10	3,193	14
Tax charge attributable to shareholders' returns	**(622)**	(906)	31	(876)	29
Profit for the year	**3,013**	2,390	26	2,317	30

***Post-tax profit - EEV*[4]**

	Actual exchange rate			Constant exchange rate	
	2018 £m	**2017 £m**	**Change %**	**2017 £m**	**Change %**
Post-tax operating profit based on longer-term investment returns					
Asia					
Long-term business	**4,387**	3,705	18	3,562	23
Asset management	**159**	155	3	150	6
Total	**4,546**	3,860	18	3,712	22
US					
Long-term business	**2,115**	2,143	(1)	2,069	2
Asset management	**3**	7	(57)	7	(57)
Total	**2,118**	2,150	(1)	2,076	2
UK and Europe					
Long-term business	**1,374**	1,015	35	1,015	35
General insurance commission	**15**	13	15	13	15
Total insurance operations	**1,389**	1,028	35	1,028	35
Asset management	**392**	403	(3)	403	(3)
Total	**1,781**	1,431	24	1,431	24
Other income and expenditure	**(726)**	(746)	3	(740)	2
Post-tax operating profit based on longer-term investment returns before restructuring costs	**7,719**	6,695	15	6,479	19
Restructuring costs[3]	**(156)**	(97)	(61)	(97)	(61)
Post-tax operating profit based on longer-term investment returns	**7,563**	6,598	15	6,382	19
Non-operating items:					
Short-term fluctuations in investment returns	**(3,219)**	2,111	n/a	2,057	n/a
Effect of changes in economic assumptions	**146**	(102)	n/a	(91)	n/a
Mark to market value on core structural borrowings	**549**	(326)	n/a	(326)	n/a
Impact of US tax reform	**-**	390	n/a	376	n/a
(Loss) gain on disposal of businesses and corporate transactions	**(451)**	80	n/a	77	n/a
Post-tax profit for the year	**4,588**	8,751	(48)	8,475	(46)

Basic earnings per share - based on operating profit after tax

	Actual exchange rate			Constant exchange rate	
	2018 pence	**2017 pence**	**Change %**	**2017 pence**	**Change %**
IFRS	**156.6**	145.2	8	140.4	12
EEV	**293.6**	257.0	14	248.6	18

***Underlying free surplus generated* [5]**

	Actual exchange rate						Constant exchange rate			
	2018 £m		**2017 £m**		**Change %**		**2017 £m**		**Change %**	
	Long-term	**Total**	**Long-term**	**Total**	**Long-term**	**Total**	**Long-term**	**Total**	**Long-term**	**Total**
Asia	**1,012**	**1,171**	923	1,078	10	9	877	1,027	15	14
US	**1,416**	**1,419**	1,321	1,328	7	7	1,275	1,282	11	11
UK and Europe	**1,175**	**1,582**	895	1,311	31	21	895	1,311	31	21
Total Group before restructuring costs	**3,603**	**4,172**	3,139	3,717	15	12	3,047	3,620	18	15
Restructuring costs[2]	**(68)**	**(125)**	(38)	(77)	(79)	(62)	(38)	(77)	(79)	(62)
Total Group	**3,535**	**4,047**	3,101	3,640	14	11	3,009	3,543	17	14

***Cash remitted by the business units to the Group*[6]**

	2018 £m	**2017 £m**	**Change %**
Asia	**699**	645	8
US	**342**	475	(28)
UK and Europe	**654**	643	2
Other UK (including Prudential Capital)	**37**	25	48
Total Group	**1,732**	1,788	(3)

Cash and capital

	2018	2017	Change %
Dividend per share relating to the reporting year	**49.35p**	47.0p	5
Holding company cash and short-term investments	**£3,236m**	£2,264m	43
Group Solvency II capital surplus[7,8]	**£17.2bn**	£13.3bn	29
Group Solvency II capital ratio[7,8]	**232%**	202%	+30pp

Group shareholders' funds (including goodwill attributable to shareholders)

	2018 £bn	2017 £bn	Change %
IFRS	**17.2**	16.1	7
EEV	**49.8**	44.7	11

	2018 %	2017 %
Return on IFRS shareholders' funds[9]	**25**	25
Return on embedded value[9]	**17**	17

	2018	2017	Change %
EEV shareholders' funds per share (including goodwill attributable to shareholders)[9]	**1,920p**	1,728p	11
EEV shareholders' funds per share (excluding goodwill attributable to shareholders)[9]	**1,856p**	1,671p	11

Notes

1 APE sales is a measure of new business activity that comprises the aggregate of annualised regular premiums and one-tenth of single premiums on new business written during the period for all insurance products, including premiums for contracts designated as investment contracts under IFRS 4. It is not representative of premium income recorded in the IFRS financial statements. See note III of the Additional unaudited IFRS financial information for further explanation.

2 Adjusted IFRS operating profit based on longer-term investment returns is management's primary measure of profitability and provides an underlying operating result based on longer-term investment returns and excludes non-operating items. Further information on its definition and reconciliation to profit for the period is set out in note B1 of the IFRS financial statements.

3 Restructuring costs include business transformation and integration costs.

4 The EEV basis results have been prepared in accordance with EEV principles discussed in note 1 of the EEV basis results. See note III of the Additional unaudited IFRS financial information for definition and reconciliation to IFRS balances.

5 For insurance operations, underlying free surplus generated represents amounts maturing from the in-force business during the period less investment in new business and excludes non-operating items. For asset management businesses, it equates to post-tax operating profit for the period. Restructuring costs are presented separately from the underlying business unit amount. Further information is set out in note 10 of the EEV basis results.

6 Cash remitted to the Group form part of the net cash flows of the holding company. A full holding company cash flow is set out in note II(a) of the Additional unaudited IFRS financial information. This differs from the IFRS Consolidated Statement of Cash Flows which includes all cash flows relating to both policyholders' and shareholders' funds. The holding company cash flow is therefore a more meaningful indicator of the Group's central liquidity.

7 The Group shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring fenced with-profit funds and staff pension schemes in surplus. The estimated solvency positions include management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date, which for both 2018 and 2017 reflects the approved regulatory position.

8 Estimated before allowing for second interim ordinary dividend.

9 See note III of the Additional unaudited IFRS financial information for definition and reconciliation of IFRS balances.

Group Chief Executive's report

I am pleased to report that we have delivered another year of positive financial performance across the Group. Through the combination of our consistent strategy, our diversified portfolio of businesses and our disciplined execution, we have continued to produce high-quality earnings and deliver consistent returns for our investors and good outcomes for all our stakeholders.

Our purpose is to help people de-risk their lives and deal with their biggest financial concerns. Whether they are starting a family, saving for a child's education or planning for old age, we provide them with the freedom to face the future with confidence through our long-term savings and protection products, retirement income solutions and asset management capabilities. At the same time, we invest our customers' savings in the real economy, helping to drive the cycle of growth and build stronger communities.

We serve this purpose through our clear, consistent strategy, which is focused on long-term structural trends and gives us unrivalled access to the world's largest and fastest-growing markets. In Asia, our distinguished brand, extensive footprint and broad product and distribution reach across 14 markets leaves us well positioned to serve the health, protection and savings needs of the rapidly growing and increasingly affluent population. We are also a leading provider of retirement products in the US, where the number of people aged 65 and older is expected to grow from 55 million in 2020 to 72 million by 2030[1], and we are continuing to enhance our product set and distribution reach to capture the opportunity in this market. In the UK and Europe, where ageing populations provide growing demand for managed savings solutions, M&GPrudential is transforming itself to meet those needs in new ways. In Africa we are building a presence in one of the world's most under-penetrated insurance markets, with operations in five markets.

We are continuing to develop our product offering and improve our capabilities in order to meet the needs of customers in all these markets. Across our businesses, we are listening to our customers and creating new and better products in response to their changing needs. At the same time, we are constantly upgrading our capabilities, including, by investing in digital technology that enables us to meet our customers' needs more quickly and efficiently.

In March 2018, we announced our intention to demerge M&GPrudential from the Group, in order to create two separately listed companies with distinct investment characteristics and opportunities. After the demerger, our shareholders will have shares in Prudential plc, which will be even better positioned to capture the structural opportunities ahead of us, and M&GPrudential, with greater freedom to deploy its capital where and how it likes to meet the changing needs of customers.

We are making good progress towards the demerger. On the structural side, we have established the holding company for M&GPrudential, and we have completed the first stage of approval from the High Court of England and Wales for the transfer of part of the M&GPrudential annuity book to Rothesay. On the operational side, we are moving forward with separating the functions of the two businesses and building new ones to prepare M&GPrudential for its post-demerger future. We have also raised £1.6 billion of subordinated debt, with substitution clauses to be activated on demerger, supporting the capital rebalancing of the two businesses, and we continue to work with our regulators.

Our financial performance

Our financial performance in 2018 reflects our focus on high quality execution of our strategy, and is again led by our business in Asia.

As in previous years, we comment on our performance in local currency terms (expressed on a constant exchange rate basis) to show the underlying business trends in periods of currency movement.

New business profit[2] increased by 11 per cent[3] to £3,877 million (up 7 per cent on an actual exchange rate basis), driven by the favourable impact of our strategic focus of increasing health and protection sales in Asia, the benefit of higher US interest rates and a resilient performance in the UK and Europe.

Group adjusted IFRS operating profit based on longer-term investment returns[4] ('operating profit') was 6 per cent[3] higher at £4,827 million (up 3 per cent on an actual exchange rate basis). Operating profit from our Asia life insurance and asset management businesses grew by 14 per cent[3], reflecting continued broad-based business momentum across the region and high-quality sales, with over 85 per cent of operating income from our preferred sources of insurance income, fee income and with-profits. In the US, Jackson's total operating profit was 11 per cent[3] lower, with higher fee income outweighed by an increase in market-related deferred acquisition costs (DAC) amortisation expense and the anticipated reduction in spread earnings. In the UK and Europe, M&GPrudential's total operating profit was 19 per cent higher than the prior year, which principally reflects the benefit from updated longevity assumptions and an 11 per cent[5] increase in the shareholder transfer from the with-profits business, which includes a 30 per cent[5] increase from PruFund.

The Group's capital generation is underpinned by our large and growing in-force business portfolio, and focus on profitable business with fast payback of capital invested. Overall, underlying free surplus generation[6] increased by 14 per cent[3] to £4,047 million and cash remittances to the Group from business units were £1,732 million (2017: £1,788 million). The Group's overall performance supported a 5 per cent increase in the 2018 full year ordinary dividend to 49.35 pence per share.

The Group remains robustly capitalised, with a 2018 year-end shareholder Solvency II cover ratio[7,8] of 232 per cent. Over the period, IFRS shareholders' funds increased by 7 per cent to £17.2 billion, reflecting profit after tax of £3,013 million (2017: £2,390 million on an actual exchange rate basis) and other movements that included dividend payments to shareholders of £1,244 million and favourable foreign exchange movements of £348 million. EEV shareholders' funds increased by 11 per cent to £49.8 billion, equivalent to 1,920 pence per share[2,9].

In Asia, we have maintained our focus on value, whilst continuing to develop our capabilities and reach, which build scale and enhance quality. Our strategic emphasis on increasing sales from health and protection business has contributed to a 14 per cent[3] increase in new business profit in Asia, and also reflected a 2 per cent[3] growth in APE sales. Our growth in new business profit was broad-based, with 10 markets delivering double-digit percentage increases[3]. Our asset management business, Eastspring Investments, has continued to grow, with operating profit up 6 per cent[3] to £182 million.

In the US, Jackson remains focused on providing financial security to increasing numbers of individuals approaching or in retirement, broadening its product range and extending its distribution network, including new relationships announced with State Farm, Envestnet and DPL Financial Partners. In 2018, higher charges for deferred acquisition costs amortisation, largely as a result of equity market movements in the year, contributed to Jackson's operating profit being 11 per cent lower. US new business profit increased by 5 per cent, as favourable movements in interest rates and spread assumptions balanced a reduction in APE sales. Jackson's hedging programmes performed as expected in the period of equity market weakness experienced towards the end of 2018, contributing to an increased risk-based capital ratio at year-end of 458 per cent (2017: 409 per cent).

In the UK and Europe, both our life and asset management businesses performed well in 2018, with operating profit 19 per cent higher driven by a number of items that are not expected to recur at the same level including the effect from updated longevity assumptions. Our core PruFund proposition continues to perform well, with net inflows of £8.5 billion and the PruFund contribution to shareholder operating profit increasing 30 per cent to £55 million. New business profit increased by 3 per cent, broadly in line with the increase in APE sales. M&GPrudential asset management saw net outflows of £9.9 billion from external clients, including the expected redemption of a single £6.5 billion low-margin institutional mandate. Overall M&GPrudential assets under management[10] were £321 billion (2017: £351 billion), reflecting net outflows at M&GPrudential asset management and the impact of the £12 billion annuity reinsurance agreement announced in March 2018.

Our financial Key Performance Indicators (KPIs) continue to reflect the outcome of the Group's strategy. Our Asia life businesses are driven by growth in our recurring premium base and focus on health and protection business. Elsewhere we are benefiting from our prioritisation of fee-generating products across our Asia asset management, US variable annuity and UK and European savings and investment activities.

A clear and proven strategy

Our clear, proven strategy is key to our long-term positive performance, and is focused on strong and growing opportunities in Asia, the US, the UK and Europe and our nascent markets in Africa.

In Asia, a large and increasingly wealthy population with low levels of insurance and asset management coverage is creating a huge and fast-growing market for our health, protection and savings products. Asia is driving global growth, with average annual GDP growth in our Asia life markets of 10.4 per cent in the decade to 2017[11], compared with just 1.9 per cent for the rest of the world[11]. Furthermore, despite potential headwinds, between 2017 and 2023 Asia is expected to deliver 39 per cent of the world's GDP growth[11]. This is creating a rapidly growing middle class in the Asia region, which is expected to double by 2030 to reach 3.5 billion people[12]. At the same time, insurance penetration in Asia is just 2.7 per cent of GDP[13], compared with 7.2 per cent in the UK[13], leaving the region vastly under-insured with an estimated mortality protection gap of US$40 trillion[14] and a health and protection gap of US$1.8 trillion[15]. Similarly, mutual fund penetration in Asia is only 12 per cent[16], compared with 96 per cent in the US[16], whilst 65 per cent of wealth in Asia is held in cash[17]. With private financial wealth in the region growing by US$5 trillion per year[17], there is considerable latent demand for our savings solutions. These structural drivers of growth are expected to persist for many years to come and create a historic opportunity for us.

We are also developing our businesses in our newer markets in Africa, which is one of the world's most underserved life markets, and where the population is forecast to grow by a billion by 2045[1]. We are now operating in five countries in Africa – Ghana, Kenya, Nigeria, Uganda and Zambia – which will increase further with the announced acquisition of a majority stake in Group Beneficial, and we are excited about the growing opportunities in this dynamic region.

We have a strong and growing opportunity in the US. About 40 million Americans are expected to reach retirement age over the next decade alone. At the same time, 72 per cent of American workers do not have access to a defined benefit retirement plan[18]. A study conducted by the Insured Retirement Institute and Jackson showed that 80 per cent of Americans think that social security will not provide enough income for retirement[19], and the same percentage are willing to pay more for guaranteed lifetime income[19]. This aligns with our retirement income products, which are designed to help customers avoid running out of money and provide them with a reliable cushion against volatile markets.

In the UK and Europe, notwithstanding the uncertainty related to the UK's intended exit from the European Union, a combination of global trends and competitive advantages is creating a powerful opportunity for M&GPrudential. Those approaching retirement have been looking for new ways to ensure a comfortable future, and since pensions freedoms were introduced in the UK in 2015 that demand has been increasing. At the same time, the total value of household cash deposits in the EU is estimated at €10 trillion[20], indicating the scale of the opportunity for asset management in the region. Private assets under management are expected nearly to double between 2017 and 2023[21]. M&GPrudential, which already has established international distribution, a clear focus on customer solutions and a broad-ranging investment capability, is transforming itself to meet this opportunity.

New and better ways to serve customers

We are continuing to improve the way we serve our customers in every part of the world in which we operate. We constantly update our products and our capabilities to ensure that we are fulfilling our purpose and maximising the effect of our strategy.

In Asia, we are continuing to develop and expand our products, distribution capabilities and footprint and to meet the evolving needs of our customers. During 2018, we broadened our product suite to include tailored propositions for the high-net-worth and corporate segments and developed new products for customers with specific needs, such as pre-existing medical conditions. Our distribution capabilities were enhanced by new digital technology and provide a seamless and differentiated customer experience from point of sale through to making a claim. At Eastspring, we also continued to roll out BlackRock's Aladdin system across our markets to improve efficiency. We broadened our reach through new partnerships with leading banks in several markets, including Thailand and the Philippines. Meanwhile, Eastspring consolidated its position as the leading retail asset manager in Asia (excluding Japan) by establishing an on-the-ground presence in China and Thailand. Early in 2019, we also renewed our successful regional strategic alliance with United Overseas Bank (UOB), one of our most successful distribution relationships in South-east Asia, until 2034 and added Vietnam and UOB's digital bank to an existing partnership presence in Singapore, Malaysia, Thailand and Indonesia.

We are also expanding our footprint in our Africa markets. In August 2018, we extended our long-term partnership with Standard Chartered Bank, which has been a huge success in Asia, to Ghana, and in November we signed a long-term exclusive partnership with Zambia National Commercial Bank Plc (Zanaco), Zambia's largest bank, to enable our market-leading products to be offered to more than a million new customers across the country.

In the US, we have a long and durable track record of delivering financial success for our consumers. We are offering new products for fee-based advisers and have launched new versions of our fee-based variable annuities. We are changing the narrative around retirement and lifetime income, demonstrating the value proposition of our products to regulators, investors, policyholders and influential industry figures. In September, we announced our collaboration with the Envestnet Insurance Exchange, to offer our products on its platform. In October, we announced a key distribution partnership with State Farm, further strengthening our market-leading distribution footprint. Early in 2019, we partnered with DPL Financial Partners to provide our protected lifetime solutions to independent registered investment advisers (RIA), providing access to new opportunities in the independent RIA channel.

In the UK and Europe, as M&GPrudential prepares for the demerger, we have been continuing to transform what we do for our customers and how we do it. Our PruFund offering continues to impress customers with its combination of clarity, capital growth and lower volatility. We are investing to transform the experience of our fast-growing digital platform, launched in 2016, to ensure it offers a comprehensive range of solutions for customers. In our investment management business, we continue to develop our private asset capacity and now have £59 billion of private assets under management, making us one of the largest private credit investors in the world, and we are looking to expand our differentiated capabilities across geographies and asset classes. In 2018, M&GPrudential also signed a new partnership with Tata Consultancy Services (TCS), a global leader in IT, business process and digital services, to enhance service for our UK and Europe savings and retirement customers.

Throughout our businesses, we are continuing to develop our digital capabilities. In Asia, such initiatives are enabling us to provide valuable and innovative services to our customers. In August, we announced our exclusive partnership agreement with the UK-based healthcare technology and services company Babylon Health. Through the deployment of cutting-edge artificial intelligence technology, this partnership will offer customers, in up to 12 of our markets in Asia, access to a comprehensive set of digital health tools, complementing Prudential Corporation Asia's existing suite of world-class protection products and strengthening our digital future. Similarly, at Eastspring, our robo-advice platform in Taiwan, in partnership with Alkanza, helps our clients meet their savings goals. We recognise that technology continually evolves and we embrace the possibilities that lie ahead. Our sponsorship of Singapore's FinTech Festival, which in 2018 had more than 400 exhibitors from 35 countries, showcasing the very latest in digital innovation, is testament to this and presents all kinds of partnership possibilities. Indeed, our Singapore business has since partnered with three of the propositions showcased at the event.

Our leadership

In July 2018, we announced that Anne Richards was resigning as Chief Executive of M&G and from the Group's Board. I would like to thank Anne for her contribution to the Group's continued success. In October 2018, we announced that Barry Stowe had decided to retire as Chairman and Chief Executive Officer of Jackson and as an Executive Director of the Group. Barry made an exceptional contribution over his 12 years at the Group, first at our Asia business, which under his leadership grew to become the market-leading operation it is today, and in the US since 2015. Barry has been succeeded at Jackson by Michael Falcon. Formerly CEO of Asia Pacific for JP Morgan Asset Management, Michael has deep expertise and an impressive track record in the industry and is well placed to lead the next phase of our development in North America. We continue to invest in the right people at all levels across the Group.

Delivering value into the future

Our clear strategy, discipline and improving capabilities have enabled us to deliver a broad-based financial performance in 2018, based on a close focus on our core purpose of helping people to de-risk their lives and deal with their biggest financial concerns. In Asia we continue to see a strong runway for the insurance and asset management industries, and our presence, scale and distribution reach position us well to participate strongly in this growth. In the US, we continue to provide Americans with the retirement strategies they need, and we are confident that this will enable us to capture additional growth into the future. In the UK and Europe, we will continue to improve service levels and launch new offerings, and we are making good progress towards the intended demerger of M&GPrudential from the Group, which will result in two distinct businesses that are able to focus more clearly on the opportunities open to us. We have an established track record of delivering important benefits to our customers and profitable growth to our shareholders. I am confident that, post demerger as independent companies, both Prudential plc and M&GPrudential will be positioned to continue to do well in the future.

Notes

1 United Nations, Department of Economic and Social Affairs, Population Division (2017). World Population Prospects: The 2017 Revision. American population reaching retirement age over the next decade is based on 2019 population, aged 55 to 64.
2 Embedded value reporting provides investors with a measure of the future profit streams of the Group. The EEV basis results have been prepared in accordance with EEV principles discussed in note 1 of EEV basis results. See note III of the Additional unaudited IFRS financial information for definition and reconciliation to IFRS balances.
3 Year-on-year percentage increases are stated on a constant exchange rate basis unless otherwise stated.
4 Adjusted IFRS operating profit based on longer-term investment returns is management's primary measure of profitability and provides an underlying operating result based on longer-term investment returns and excludes non-operating items. Further information on its definition and reconciliation to profit for the period is set out in note B1 of the IFRS financial statements.
5 Growth rate on an actual exchange rate basis.
6 For insurance operations, underlying free surplus generated represents amounts maturing from the in-force business during the period less investment in new business and excludes non-operating items. For asset management businesses it equates to post-tax operating profit for the period. Restructuring costs are presented separately from the underlying business unit amount. Further information is set out in note 10 of the EEV basis results.
7 The Group shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring fenced with-profit funds and staff pension schemes in surplus. The estimated solvency positions include management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date, which for both 2018 and 2017 reflects the approved regulatory position.
8 Estimated before allowing for second interim ordinary dividend.
9 See note III of the Additional unaudited IFRS financial information for definition and reconciliation to IFRS balances.
10 Represents M&GPrudential asset management external funds under management and internal funds included on the M&GPrudential long-term insurance business balance sheet.
11 IMF. 2017 GDP at January 2019 current prices. Asia represents Prudential Corporation Asia's life business footprint.
12 Brookings Institution. Global Economy & Development Working Paper 100. February 2017. 'Asia' represents Asia Pacific.
13 Insurance penetration – Swiss Re Sigma No 3/2018. Insurance penetration calculated as premiums as a percentage of GDP. Asia penetration calculated on a weighted population basis.
14 Swiss Re Mortality Protection Gap Asia Pacific 2018. Represents Prudential Corporation Asia's life business footprint, and use per capita income of working population as the base unit to calculate the size of the gap.
15 Swiss Re Asia's health protection gap: insights for building greater resilience. October 2018. Represents China, India, Japan, Korea, Indonesia, Malaysia, Taiwan, Vietnam, the Philippines, Singapore, Hong Kong and Thailand.
16 Investment Company Institute, industry associations and Lipper.
17 BCG Global Wealth 2017. Navigating the New Client Landscape.
18 U.S. Bureau of Labor Statistics, National Compensation. Survey: Employee Benefits in the United States, March 2017. Workers defined as those employed in private industry and state and local government.
19 The Language of Retirement 2017 – study conducted on behalf of the Insured Retirement Institute and Jackson.
20 Eurostat: Household deposit data.
21 Preqin Future of Alternatives Report, October 2018.

Chief Financial Officer's report on the 2018 financial performance

I am pleased to report that Prudential's financial performance in 2018 reflects our strategic focus on driving growth in high-quality, recurring health and protection and fee business across our geographies, products and distribution channels.

I am encouraged that our financial performance has been accomplished at the same time as the Group has made good progress in the complex preparations for the intended demerger of M&GPrudential from Prudential plc, which we announced in March 2018. We have achieved a number of important milestones, including the reinsurance of £12 billion of UK annuity policies to Rothesay Life, the transfer of the Hong Kong insurance subsidiaries to Prudential Corporation Asia, the issuance of £1.6 billion of substitutable debt as part of the necessary rebalancing of capital across the two businesses, the establishment of a new holding company for M&GPrudential and the transfer of UK operating subsidiaries to that company.

Our financial performance was led by our Asia business which delivered double digit growth in new business profit (up 14 per cent[1]), adjusted IFRS operating profit based on longer-term investment returns ('operating profit') (up 14 per cent[1]) and underlying free surplus generation[2] (up 14 per cent[1]). This performance is both broad-based, with 10 markets achieving double-digit growth[1] in new business profit, and high-quality, with health and protection new business profit growing by 15 per cent[1]. Our Asia asset manager, Eastspring, has grown operating profit by 6 per cent amidst a challenging external environment. Our broad-based portfolio of life insurance and asset management businesses, high-quality products with distinctive value-added services and multi-channel strategy ensure that we continue to benefit from the growing customer demand in Asia for health, protection and savings solutions that we provide.

In the US, we saw growth in fee income driven by higher average account balances offset by an increase in market-related deferred acquisition costs (DAC) amortisation and an expected reduction in spread-based revenues, leading to a fall in operating profit of 11 per cent. Jackson's hedge programme performed as expected as equity markets weakened towards the end of 2018 and contributed to an increased risk-based capital ratio of 458 per cent, up from 409 per cent at year-end 2017.

M&GPrudential delivered operating profit of £1,634 million, up 19 per cent (2017: £1,378 million). This included £519 million (2017: £597 million) from our core[3] with-profits and annuity business, with the with-profits contribution up 11 per cent to £320 million, offset by lower annuities earnings following the reinsurance of £12 billion[4] of liabilities in March 2018. Other operating profits included the benefit of updated longevity assumptions and an insurance recovery on the costs of reviewing internally vesting annuity sales. M&GPrudential remains on track to deliver the announced annual shareholder cost savings of circa £145 million by 2022 for a shareholder investment of circa £250 million.

Sterling weakened over the course of 2018, compared with most of the currencies in our major international markets. However, average exchange rates remained above those in 2017, leading to a negative effect on the translation of the results from non-sterling operations. To aid comparison of underlying progress, we continue to express and comment on the performance trends in our Asia and US operations on a constant exchange rate basis.

The performance of many equity markets was subdued in 2018, and was characterised by higher levels of volatility. The S&P 500 closed the year 6 per cent lower than 2017, the FTSE 100 index was down 12 per cent and the MSCI Asia excluding Japan index down 16 per cent. However, average balances, which have the most material impact on our fee-based earnings during the year, were mostly higher, reflecting the concentration of equity market weakness in the fourth quarter. Long-term yields increased favourably in the US and our larger Asia markets, but were only slightly higher in the UK.

The key financial highlights in 2018 were as follows:

- **New business profit** was 11 per cent higher at £3,877 million (7 per cent on an actual exchange rate basis), while **APE sales** were up 1 per cent (down 2 per cent on an actual exchange rate basis). In Asia, new business profit increased 14 per cent with improved new business margins primarily reflecting product mix. Jackson's new business profit increased by 5 per cent, primarily reflecting the favourable effect of higher US interest rates. UK and Europe life new business profit grew by 3 per cent, driven by a 2 per cent increase in APE sales, supported by continued demand for products offering access to our PruFund investment proposition.

- **Asset management net outflows** of £11.5 billion reflected external net outflows of £9.9 billion (2017: net inflows of £17.3 billion) within M&GPrudential asset management, the majority of which related to the expected redemption of a single, low-margin £6.5 billion institutional mandate, with the remainder reflecting the challenging market environment for equity and fixed income business. Eastspring saw external net outflows, excluding money market funds, of £1.6 billion (2017: net inflows of £3.1 billion on an actual exchange rate basis), also as a result of market conditions.

- **Operating profit** was 6 per cent higher at £4,827 million (3 per cent higher on an actual exchange rate basis). Continued business momentum helped grow Asia's operating profit by 14 per cent to £2,164 million and M&GPrudential operating profit was 19 per cent higher, reflecting a number of beneficial impacts, which are not expected to recur at the same level. In the US, operating profit decreased by 11 per cent, as a result of higher market-related DAC amortisation charges.

- **Total IFRS post-tax profit** was up 30 per cent at £3,013 million (26 per cent on an actual exchange rate basis) after a £508 million pre-tax loss following the reinsurance of £12 billion[4] of UK annuities to Rothesay Life. This increase was driven by Jackson, whose IFRS profit after tax in 2018 was £1,484 million, up from £245 million (£254 million on an actual exchange rate basis) reflecting higher interest rates and gains from Jackson's hedging instruments as equity markets fell towards the end of 2018. **Group IFRS shareholders' equity** was 7 per cent higher at £17.2 billion.

- **EEV basis operating profit**, including embedded value in-force profit, increased 19 per cent (15 per cent on an actual exchange rate basis) to £7,563 million. EEV basis shareholders' equity was up 11 per cent at £49.8 billion.

- **Underlying free surplus generation**[2], our preferred measure of cash generation, from our life and asset management businesses, increased by 14 per cent to £4,047 million (11 per cent on an actual exchange rate basis), after financing new business growth. This was driven by in-force growth of 10 per cent combined with a lower level of investment in new UK and Europe business as a result of management actions to optimise capital absorption.

- **Group shareholders' Solvency II capital surplus**[5] was estimated at £17.2 billion at 31 December 2018, equivalent to a cover ratio of 232 per cent[6] (31 December 2017: £13.3 billion, 202 per cent). The improvement in the period reflects the continuing strength of the Group's operating capital generation and a net £1.2 billion increase in qualifying debt.

- **Full year ordinary dividend** increased by 5 per cent to 49.35 pence per share, reflecting our 2018 performance and our confidence in the future prospects of our businesses.

IFRS profit

	Actual exchange rate			Constant exchange rate	
	2018 £m	**2017 £m**	**Change %**	**2017 £m**	**Change %**
Operating profit before tax based on longer-term investment returns					
Asia					
Long-term business	**1,982**	1,799	10	1,727	15
Asset management	**182**	176	3	171	6
Total	**2,164**	1,975	10	1,898	14
US					
Long-term business	**1,911**	2,214	(14)	2,137	(11)
Asset management	**8**	10	(20)	9	(11)
Total	**1,919**	2,224	(14)	2,146	(11)
UK and Europe					
Long-term business	**1,138**	861	32	861	32
General insurance commission	**19**	17	12	17	12
Total insurance operations	**1,157**	878	32	878	32
Asset management	**477**	500	(5)	500	(5)
Total	**1,634**	1,378	19	1,378	19
Other income and expenditure	**(725)**	(775)	6	(769)	6
Total operating profit based on longer-term investment returns before tax and restructuring costs	**4,992**	4,802	4	4,653	7
Restructuring costs	**(165)**	(103)	(60)	(103)	(60)
Total operating profit based on longer-term investment returns before tax	**4,827**	4,699	3	4,550	6
Non-operating items:					
Short-term fluctuations in investment returns on shareholder-backed business	**(558)**	(1,563)	64	(1,514)	63
Amortisation of acquisition accounting adjustments	**(46)**	(63)	27	(61)	25
(Loss) gain on disposal of businesses and corporate transactions	**(588)**	223	n/a	218	n/a
Profit before tax	**3,635**	3,296	10	3,193	14
Tax charge attributable to shareholders' returns	**(622)**	(906)	31	(876)	29
Profit for the year	**3,013**	2,390	26	2,317	30

IFRS earnings per share

	Actual exchange rate			Constant exchange rate	
	2018 pence	**2017 pence**	**Change %**	**2017 pence**	**Change %**
Basic earnings per share based on operating profit after tax	**156.6**	145.2	8	140.4	12
Basic earnings per share based on total profit after tax	**116.9**	93.1	26	90.0	30

Adjusted IFRS operating profit based on longer-term investment returns (operating profit)
2018 total operating profit increased by 6 per cent (3 per cent on an actual exchange rate basis) to £4,827 million.

Asia total operating profit of £2,164 million was 14 per cent higher than the previous year (10 per cent on an actual exchange rate basis). Operating profit from life insurance operations increased 15 per cent to £1,982 million (10 per cent on an actual exchange rate basis), reflecting the continued growth of our in-force book of recurring premium business, with renewal insurance premiums[7] reaching £12,856 million (2017: £11,087 million). Insurance margin was up 15 per cent, driven by our continued focus on health and protection business, now contributing to 70 per cent of Asia life insurance revenues[8] (2017: 68 per cent). At a market level, growth was led by Hong Kong up 33 per cent, Singapore 22 per cent and China 20 per cent respectively. Eastspring's operating profit increased by 6 per cent (up 3 per cent on an actual exchange rate basis) to £182 million reflecting 4 per cent revenue growth which, combined with positive operating leverage, resulted in an improvement in the cost-income ratio[7] to 55 per cent (2017: 56 per cent on an actual exchange rate basis).

US total operating profit at £1,919 million decreased by 11 per cent (14 per cent on an actual exchange rate basis). Higher fee income was more than offset by higher market-related DAC amortisation and lower spread-based income. Although equity markets declined in the fourth quarter, average separate account balances were above the prior year, given positive net inflows which supported higher levels of fee income. The higher market-related DAC amortisation arises mainly from £194 million acceleration of amortisation compared with £83 million favourable deceleration in 2017 (on a constant exchange rate basis), leading to an adverse year-on-year movement of £277 million. Excluding the acceleration and deceleration in 2018 and 2017, operating profit in 2018 would have been 2 per cent higher than 2017 on a constant exchange rate basis. The variability in DAC from year-on-year is dependent on separate account return and its interaction with the mean reversion formula applied by Jackson when determining the amortisation charge for the year. In the current year the dominant factors driving this calculation have been the equity market falls in 2018 (whereas 2017 saw equity market rises). Spread-based income decreased 20 per cent (22 per cent on an actual exchange rate basis), as anticipated, reflecting the impact of lower yields on our fixed annuity portfolio and a reduced contribution from asset duration swaps. While we expect these effects to continue to compress spread margins, the continued upwards movements in US reinvestment yields may help to reduce the speed of the decline.

UK and Europe total operating profit was 19 per cent higher at £1,634 million. Life insurance operating profit increased by 32 per cent to £1,138 million (2017: £861 million). Within this total, the contribution from our core[3] with-profits and in-force annuity business was £519 million (2017: £597 million), including an increased transfer to shareholders from the with-profits funds of £320 million (2017: £288 million) and within this, a 30 per cent increase in the contribution from PruFund business of £55 million. Earnings from our core[3] annuities business were lower, reflecting the reinsurance of £12 billion of annuity liabilities to Rothesay Life in March 2018. The balance of the life insurance result reflects the contribution from other elements which are not expected to recur at the same level. This includes the favourable impact of longevity assumption changes, contributing £441 million (2017: £204 million) relating to changes to annuitant mortality assumptions reflecting recent mortality trends, which have shown a slowdown in life expectancy improvements in recent periods, and the adoption of the Continuous Mortality Investigation (CMI) 2016 model (2017: adoption of 2015 model). The result also includes a £166 million insurance recovery, related to the costs of reviewing internally vesting annuities sold without advice after July 2008. Profits from management actions of £58 million were broadly offset by a provision of £55 million for the cost of equalising guaranteed minimum pension benefits on products sold by the UK insurance business, following a High Court ruling in October which applied across the UK life insurance industry.

Asset management operating profit decreased 5 per cent to £477 million, largely reflecting a normalisation of performance fees to £15 million, compared with a particularly high contribution of £53 million in the prior year. Excluding the contribution of performance fees, operating profit was 3 per cent higher. This reflects both the higher average level of funds managed by M&G (up from £275.9 billion in 2017 to £276.6 billion in 2018) and a higher revenue margin[9] of 40 basis points (2017: 37 basis points). Operating profit is after charges of £27 million incurred in preparing the business for the UK's proposed exit from the European Union, including the migration of fund assets to our Luxembourg-domiciled SICAV platform. The cost-income ratio[7] of 59 per cent remains broadly in line with the prior year (2017: 58 per cent).

Life insurance profit drivers

We track the progress that we make in growing our life insurance business by reference to the scale of our obligations to our customers, which are referred to in the financial statements as policyholder liabilities. Each period these increase as we write new business and collect regular premiums from existing customers and decrease as we pay claims and policies mature. These policyholder liabilities contribute, for example, to our ability to earn fees on the unit-linked element and indicates the scale of the insurance element, another key source of profitability for the Group.

Shareholder-backed policyholder liabilities and net liability flows[10]

	2018 £m				2017 £m			
	Actual exchange rate				Actual exchange rate			
	At 1 January	Net liability flows[11]	Market and other movements	At 31 December	At 1 January	Net liability flows[11]	Market and other movements	At 31 December
Asia	**37,402**	**3,251**	**(56)**	**40,597**	32,851	2,301	2,250	37,402
US	**180,724**	**(213)**	**5,089**	**185,600**	177,626	3,137	(39)	180,724
UK and Europe	**56,367**	**(2,774)**	**(12,833)**	**40,760**	56,158	(2,721)	2,930	56,367
Total Group	**274,493**	**264**	**(7,800)**	**266,957**	266,635	2,717	5,141	274,493

Focusing on business supported by shareholder capital, which generates the majority of the life profit, in 2018 net flows into our businesses were overall positive at £0.3 billion driven by our Asian operations. In the US, net outflows were £0.2 billion with positive separate account net inflows of £1.1 billion being more than offset by general account net outflows of £1.3 billion, as a result of higher surrenders as the portfolio develops. In the UK and Europe, the net outflows principally reflect the run-off of the in-force annuity portfolio following our effective withdrawal from selling new annuity business. Market and other movements have reduced shareholder-back liabilities by £7.8 billion. This includes the removal of £10.9 billion[4] of UK annuity liabilities, representing the portion of the £12 billion[4] reinsured liabilities that will be subject to a Part VII transfer to Rothesay Life, following their reclassification as held for sale, offset by additions of £4.1 billion in Jackson as a result of the agreement in November 2018 to reinsure a portfolio of business from John Hancock. The remaining £1.0 billion primarily reflects the effects of negative investment markets offset by currency effects as sterling weakened over the period. In total, business flows and market movements have decreased shareholder-backed policyholder liabilities from £274.5 billion to £267.0 billion.

Policyholder liabilities and net liability flows in with-profits business[10,12]

	2018 £m				2017 £m			
	Actual exchange rate				Actual exchange rate			
	At 1 January	Net liability flows[11]	Market and other movements	At 31 December	At 1 January	Net liability flows[11]	Market and other movements	At 31 December
Asia	**36,437**	**5,165**	**564**	**42,166**	29,933	4,574	1,930	36,437
UK and Europe	**124,699**	**3,209**	**(3,779)**	**124,129**	113,146	3,457	8,096	124,699
Total Group	**161,136**	**8,374**	**(3,215)**	**166,295**	143,079	8,031	10,026	161,136

Policyholder liabilities in our with-profits business have increased by 3 per cent to £166.3 billion reflecting the popularity of our participating funds in Asia and PruFund in the UK, as consumers seek protection from some of the short-term ups and downs of direct stock market investments by using an established smoothing process. Across our Asia and UK and Europe operations, net liability flows increased to £8.4 billion. As returns from these funds are smoothed and shared with customers, the emergence of shareholder profit is more gradual. This business, nevertheless, remains an important source of future shareholder value.

Analysis of long-term insurance business pre-tax adjusted IFRS operating profit based on longer-term investment returns by driver

	Actual exchange rate						Constant exchange rate		
	2018			2017			2017		
	Operating profit £m	**Average liability £m**	**Margin bps**	**Operating profit £m**	**Average liability £m**	**Margin bps**	**Operating profit £m**	**Average liability £m**	**Margin bps**
Spread income	**899**	**85,850**	**105**	1,122	88,908	126	1,090	87,553	124
Fee income	**2,711**	**175,443**	**155**	2,609	166,839	156	2,518	162,267	155
With-profits	**391**	**147,318**	**27**	347	136,474	25	345	136,496	25
Insurance margin	**2,480**			2,302			2,223		
Margin on revenues	**2,254**			2,287			2,210		
Expenses:									
Acquisition costs*	**(2,319)**	**6,802**	**(34)%**	(2,443)	6,958	(35)%	(2,364)	6,767	(35)%
Administration expenses	**(2,413)**	**265,597**	**(91)**	(2,305)	261,114	(88)	(2,231)	255,313	(87)
DAC adjustments	**216**			505			490		
Expected return on shareholder assets	**242**			234			228		
	4,461			4,658			4,509		
Other items**	**570**			216			216		
Long-term business adjusted IFRS operating profit based on longer-term investment returns	**5,031**			4,874			4,725		

* The ratio of acquisition costs is calculated as a percentage of APE sales including with-profits sales. The acquisition costs include only those relating to shareholders backed business.

** Other items includes share of related tax charges from joint ventures and associate and other items considered non-core to the UK and Europe business, see note I(a) of the Additional unaudited IFRS financial information.

We continue to maintain our preference for high-quality sources of income such as insurance margin from life and health and protection business, and fee income. We favour insurance margin because it is relatively insensitive to the equity and interest rate cycle and prefer fee income to spread income because it is more capital-efficient. In line with this approach, on a constant exchange rate basis, insurance margin has increased by 12 per cent (up 8 per cent on an actual exchange rate basis) and fee income by 8 per cent (up 4 per cent on an actual exchange rate basis), while as anticipated, spread income decreased by 18 per cent (down 20 per cent on an actual exchange rate basis). Administration expenses increased to £2,413 million (2017: £2,231 million) as the business continues to expand in Asia, alongside higher asset-based commissions within the US business, which are treated as an administrative expense in this analysis.

Asset management profit drivers

Movements in asset management operating profit are also influenced primarily by changes in the scale of these businesses, as measured by funds managed on behalf of external institutional and retail customers and our internal life insurance operations.

Asset management external funds under management[13,14]

	2018 £m				2017 £m			
	Actual exchange rate				Actual exchange rate			
	At 1 January	**Net flows**	**Market and other movements**	**At 31 December**	**At 1 January**	**Net flows**	**Market and other movements**	**At 31 December**
UK and Europe	**163,855**	**(9,915)**	**(6,994)**	**146,946**	136,763	17,337	9,755	163,855
Asia[15]	**46,568**	**(1,586)**	**4,473**	**49,455**	38,042	3,141	5,385	46,568
Total asset management	**210,423**	**(11,501)**	**(2,521)**	**196,401**	174,805	20,478	15,140	210,423
Total asset management (including MMF)	**219,740**	**(10,001)**	**(1,736)**	**208,003**	182,519	21,973	15,248	219,740

M&GPrudential's external asset management net outflows were £9.9 billion (2017: net inflows of £17.3 billion) driven by the expected redemption of a single £6.5 billion low-margin institutional mandate, and net outflows from wholesale and direct clients from bond and equity classes in volatile financial markets. This was partially offset by inflows into multi-asset wholesale offerings and other institutional business products, including public debt and illiquid credit strategies. Internal life insurance assets under management were £174.3 billion (2017: £186.8 billion) benefiting from PruFund net flows of £8.5 billion, offset by the effect of the £12 billion[4] annuities reinsurance and lower equity market levels. As a result, total M&GPrudential assets under management[16] reduced to £321.2 billion (2017: £350.7 billion).

Eastspring's external assets under management, excluding money market funds, increased by 6 per cent (on an actual exchange rate basis) to £49.5 billion, reflecting the acquisition of TMB Asset Management, which added £9 billion, offset by client outflows and adverse market movements. Higher internal assets under management, driven by inflows into the life business and money market funds, lifted Eastspring's total assets under management to £151.3 billion.

Other income and expenditure and restructuring costs

Other income and expenditure consists of interest payable on core structural borrowings, corporate expenditure and other income. These items, together with restructuring costs, increased 2 per cent to a net charge of £890 million (2017: £872 million). This reflects higher restructuring costs of £165 million (2017: £103 million), partly offset by a lower interest expense. Restructuring costs include investment spend of £99 million in relation to M&GPrudential merger and transformation bringing the cumulative cost to £143 million, on an IFRS basis, since the project began. Other restructuring costs relate to efficiency and change programmes across the Group, for example the rationalisation of US locations in 2018.

IFRS basis non-operating items

Non-operating items consist of short-term fluctuations in investment returns on shareholder-backed business of negative £558 million (2017: negative £1,514 million), the results attaching to disposal of businesses of negative £588 million (2017: positive £218 million), and the amortisation of acquisition accounting adjustments of negative £46 million (2017: negative £61 million) arising mainly from the REALIC business acquired by Jackson in 2012. The loss related to the disposal of businesses relates primarily to the £508 million pre-tax loss following the reinsurance of £12 billion[4] UK annuities to Rothesay Life in March 2018.

Short-term fluctuations in investment returns on shareholder-backed business are discussed further below.

IFRS basis short-term fluctuations in investment returns on shareholder-backed business
Operating profit is based on longer-term investment return assumptions. The difference between actual investment returns recorded in the income statement and the assumed longer-term returns is reported within short-term fluctuations in investment returns.

In 2018, the total short-term fluctuations in investment returns on shareholder-backed business were negative £558 million (2017: negative £1,563 million on an actual exchange rate basis) and comprised negative £512 million (2017: negative £1 million on an actual exchange rate basis) for Asia, negative £100 million (2017: negative £1,568 million on an actual exchange rate basis) in the US, positive £34 million (2017: negative £14 million on an actual exchange rate basis) in the UK and Europe and positive £20 million (2017: positive £20 million on an actual exchange rate basis) in other operations.

Rising interest rates in many territories in Asia led to unrealised bond losses in the period. In the US, lower equity market levels, alongside higher interest rate levels, as expected, resulted in gains on equity hedge instruments which are designed to protect Jackson's capital position, balanced by higher technical reserve requirements.

IFRS basis effective tax rates
In 2018, the effective tax rate on operating profit was 16 per cent (2017: 21 per cent), reflecting the reduction in the US federal tax rate from 35 per cent in 2017 to 21 per cent in 2018.

The 2018 effective tax rate on the total IFRS profit was 17 per cent (2017: 14 per cent after excluding the one-off impact of the re-measurement of US deferred tax balances, following the enactment in December 2017 of tax reform in the US). The increase in the 2018 effective tax rate reflects non-tax deductible investment losses in Asia operations.

The main driver of the Group's effective tax rate is the relative mix of the profits between jurisdictions with higher tax rates (such as Indonesia and Malaysia), jurisdictions with lower tax rates (such as Hong Kong and Singapore), and jurisdictions with rates in between (such as the UK and the US).

Total tax contribution
The Group continues to make significant tax contributions in the jurisdictions in which it operates, with £2,839 million remitted to tax authorities in 2018. This was similar to the equivalent amount of £2,903 million remitted in 2017.

Tax strategy
In May 2018, the Group published its updated tax strategy which, in addition to complying with the mandatory UK (Finance Act 2016) requirements, also included a number of additional disclosures, including a breakdown of revenues, profits and taxes for all jurisdictions where more than £5 million tax was paid. This disclosure was included as a way of demonstrating that our tax footprint (ie where we pay taxes) is consistent with our business footprint. An updated version of the tax strategy, including 2018 data, will be available on the Group's website before 31 May 2019.

New business performance

Life EEV new business profit and APE new business sales (APE sales)

	Actual exchange rate						Constant exchange rate			
	2018 £m		2017 £m		Change %		2017 £m		Change %	
	APE sales	New business profit	APE sales	New business profit	APE sales	New business profit	APE sales	New business profit	APE sales	New business profit
Asia	**3,744**	**2,604**	3,805	2,368	(2)	10	3,671	2,282	2	14
US	**1,542**	**921**	1,662	906	(7)	2	1,605	874	(4)	5
UK and Europe	**1,516**	**352**	1,491	342	2	3	1,491	342	2	3
Total Group	**6,802**	**3,877**	6,958	3,616	(2)	7	6,767	3,498	1	11

Life insurance new business profit was up 11 per cent (7 per cent on an actual exchange rate basis) to £3,877 million, and **life insurance new business APE sales** increased by 1 per cent (decreased by 2 per cent on an actual exchange rate basis) to £6,802 million, including an increase of 4 per cent during the second half of 2018 compared with the second half of 2017, led by 8 per cent growth in Asia.

In **Asia**, new business profit was 14 per cent higher at £2,604 million (10 per cent on an actual exchange rate basis), benefiting from pricing actions and our strategic focus on health and protection sales. This growth was also supported by increasing sales momentum, with APE growth of 8 per cent during the second half of 2018 compared with the second half of 2017.

Our focus on quality is undiminished, with regular premium contracts accounting for 94 per cent of APE sales as well as the mix of health and protection products increasing to 28 per cent of APE sales. Overall, new business profit from health and protection products was 15 per cent higher and contributed 70 per cent of the total in Asia. This favourable mix provides a high level of recurring income and an earnings profile that is significantly less correlated to investment markets.

The performance remains broad-based, with 10 markets delivering double-digit percentage growth in new business profit. In Hong Kong, new business profit increased by 17 per cent, driven largely by our ongoing focus on increasing health and protection sales, particularly those with more comprehensive coverage. Hong Kong APE sales increased by 3 per cent overall, with higher sales levels from Mainland China visitors to Hong Kong driving positive momentum over the course of the year, culminating in APE sales growth of 18 per cent in the discrete fourth quarter. In China, new business profit increased by 14 per cent, reflecting positive product mix effects, and APE sales growth of 27 per cent in the fourth quarter. In Singapore, new business profit increased by 15 per cent on higher APE sales (up 5 per cent), driven by our agency and bancassurance channels, pricing actions and favourable product mix shifts. Growth in new business profit in Thailand (up 75 per cent), Vietnam (up 29 per cent) and Malaysia (up 13 per cent) reflects our value focus and favourable shifts in product mix. Our Indonesia business continues to experience challenging conditions which, compounded by the adverse impact of higher yields, drove new business profit lower by 23 per cent. Despite these headwinds, we are investing in the business to strengthen our distribution capabilities, upgrading our systems and refreshing our product propositions to meet customer needs.

In the **US**, new business profit increased by 5 per cent to £921 million (up 2 per cent on an actual exchange rate basis) as a 4 per cent reduction in new APE sales was more than balanced by the favourable effect of higher interest rates and spread assumption changes compared with the prior period.

In our **UK and Europe life business**, new business profit increased to £352 million, up 3 per cent supported by 2 per cent growth in APE sales. New sales continue to be driven by the popular PruFund proposition with APE sales up 3 per cent. Reflecting this performance, total PruFund assets under management of £43 billion as at 31 December 2018 were 20 per cent higher than at the start of the year, driven by positive net flows of £8.5 billion.

Free surplus generation[2]

	Actual exchange rate			Constant exchange rate	
	2018 £m	**2017 £m**	**Change %**	**2017 £m**	**Change %**
Free surplus generation					
Asia	**1,659**	1,562	6	1,493	11
US	**1,644**	1,582	4	1,527	8
UK and Europe	**1,684**	1,486	13	1,486	13
Underlying free surplus generated from in-force life business and asset management before restructuring costs	**4,987**	4,630	8	4,506	11
Restructuring costs	**(125)**	(77)	(62)	(77)	(62)
Underlying free surplus generated from in-force life business and asset management	**4,862**	4,553	7	4,429	10
Investment in new business	**(815)**	(913)	11	(886)	8
Underlying free surplus generated	**4,047**	3,640	11	3,543	14
Market related movements, timing differences and other non-operating movements	**(1,282)**	(1,012)			
Profit attaching to corporate transactions	**283**	172			
Net cash remitted by business units	**(1,732)**	(1,788)			
Total movement in free surplus	**1,316**	1,012			
Free surplus at end of year	**8,894**	7,578			

Free surplus generation is the financial metric we use to measure the internal cash generation of our business operations and is based on the capital regimes that apply locally in the various jurisdictions, in which our life businesses operate. For life insurance operations, it represents amounts maturing from the in-force business during the year, net of amounts reinvested in writing new business. For asset management businesses, it equates to post-tax operating profit for the period.

We drive free surplus generation by targeting markets and products that have low capital strain, high-return and fast payback profiles and by delivering both good service and value to improve customer retention. Our ability to generate both growth and cash is a distinctive feature of Prudential.

In 2018, underlying free surplus generation from our life insurance and asset management business, before investment in new business, increased by 10 per cent to £4,862 million (increased by 7 per cent on an actual exchange rate basis), reflecting increased contributions from all our businesses. In Asia, growth in the in-force life portfolio, combined with post-tax asset management profit from Eastspring, contributed to free surplus generation of £1,659 million, up 11 per cent. In the US, in-force free surplus generation increased by 8 per cent reflecting higher in-force values. In the UK and Europe, in-force free surplus generation increased by 13 per cent to £1,684 million, including the positive impact of longevity assumption changes and the £138 million post-tax insurance recovery for the costs of the UK review of past non-advised annuity sales practices and related potential redress. In 2017 free surplus was reduced by an increase in the related provision of £187 million to cover such costs.

Although new business profit increased by 11 per cent, the amount of free surplus invested in writing new life business in the period was lower at £815 million (2017: £886 million) primarily reflecting lower sales in the US and measures taken to optimise capital absorption in the UK and Europe.

After funding cash remittances from the business units to the Group, recognition of the profit attaching to the disposal of businesses, and other movements, which includes market movements, the closing value of free surplus in our life and asset management operations was £8.9 billion at 31 December 2018.

We continue to manage cash flows across the Group with a view to achieving a balance between ensuring sufficient remittances are made to service central requirements (including paying the external dividend) and maximising value to shareholders through retention and reinvestment of capital in business opportunities.

Business unit remittance[17]

	Actual exchange rate	
	2018 £m	**2017 £m**
Net cash remitted by business units:		
Asia	**699**	645
US	**342**	475
UK and Europe	**654**	643
Other UK (including Prudential Capital)	**37**	25
Net cash remitted by business units	**1,732**	1,788
Holding company cash at 31 December	**3,236**	2,264

Cash remitted to the Group by business units in 2018 amounted to £1,732 million, driven by higher remittances from Asia, demonstrating the quality and scale of its growth. Jackson made remittances of £342 million, although lower than the prior period. The remittance from M&GPrudential of £654 million was 2 per cent higher than the combined remittance in 2017, with an increase in the with-profits transfer from £215 million in 2017 to £233 million in 2018.

Cash remitted to the Group in 2018 was used to meet central costs of £430 million (2017: £470 million) and pay the 2017 second interim and 2018 first interim dividends. As well as these movements were corporate activities and other cash flows of positive £914 million (2017: negative £521 million), primarily driven by net debt issuance of £1.2 billion within the year. This led to holding company cash increasing from £2,264 million to £3,236 million over 2018.

Post-tax profit - EEV

	Actual exchange rate			Constant exchange rate	
	2018 £m	**2017 £m**	**Change %**	**2017 £m**	**Change %**
Post-tax operating profit based on longer-term investment returns					
Asia					
Long-term business	**4,387**	3,705	18	3,562	23
Asset management	**159**	155	3	150	6
Total	**4,546**	3,860	18	3,712	22
US					
Long-term business	**2,115**	2,143	(1)	2,069	2
Asset management	**3**	7	(57)	7	(57)
Total	**2,118**	2,150	(1)	2,076	2
UK and Europe					
Long-term business	**1,374**	1,015	35	1,015	35
General insurance commission	**15**	13	15	13	15
Total insurance operations	**1,389**	1,028	35	1,028	35
Asset management	**392**	403	(3)	403	(3)
Total	**1,781**	1,431	24	1,431	24
Other income and expenditure	**(726)**	(746)	3	(740)	2
Post-tax operating profit based on longer-term investment returns before restructuring costs	**7,719**	6,695	15	6,479	19
Restructuring costs	**(156)**	(97)	(61)	(97)	(61)
Post-tax operating profit based on longer-term investment returns	**7,563**	6,598	15	6,382	19
Non-operating items:					
Short-term fluctuations in investment returns	**(3,219)**	2,111	n/a	2,057	n/a
Effect of changes in economic assumptions	**146**	(102)	n/a	(91)	n/a
Mark to market value on core structural borrowings	**549**	(326)	n/a	(326)	n/a
Impact of US tax reform	**-**	390	n/a	376	n/a
(Loss) gain on disposal of businesses and corporate transactions	**(451)**	80	n/a	77	n/a
Post-tax profit for the year	**4,588**	8,751	(48)	8,475	(46)

Earnings per share - EEV

	Actual exchange rate			Constant exchange rate	
	2018 pence	**2017 pence**	**Change %**	**2017 pence**	**Change %**
Basic earnings per share based on post-tax operating profit	**293.6**	257.0	14	248.6	18
Basic earnings per share based on post-tax total profit	**178.1**	340.9	(48)	330.2	(46)

EEV operating profit

On an EEV basis, Group post-tax operating profit based on longer-term investment return increased by 19 per cent (up 15 per cent on an actual exchange rate basis) to £7,563 million in 2018.

EEV operating profit includes new business profit from the Group's life business, which increased by 11 per cent (up 7 per cent on an actual exchange rate basis) to £3,877 million. It also includes in-force life business profit of £3,999 million, which was 27 per cent higher than prior year (up 23 per cent on an actual exchange rate basis), primarily reflecting the growth in our in-force business and higher interest rates. This is most evident in the profit from the unwind of the in-force business, which was 22 per cent higher at £2,573 million. Experience and assumption changes were positive at £1,426 million (2017: £1,044 million), reflecting the continuing performance of our in-force policies.

In **Asia**, EEV life operating profit was up 23 per cent to £4,387 million, driven by 14 per cent growth in new business profit and 39 per cent growth in in-force profit, reflecting the growth of the in-force business and positive assumption changes and experience variances, as a result of the high quality of the existing portfolio.

Jackson's EEV life operating profit was up 2 per cent to £2,115 million. This reflects a 5 per cent increase in new business profit to £921 million and higher expected returns from the in-force business due to prior period growth and higher interest rates, partially offset by a reduced level of favourable assumption changes and experience variances.

In the **UK and Europe**, EEV life operating profit increased by 35 per cent to £1,374 million (2017: £1,015 million). This was as a result of a 3 per cent increase in new business profit, and higher in-force profit which included a £330 million benefit from revisions to longevity assumptions and a £138 million insurance recovery related to the costs of reviewing past annuity sales after 1 July 2008, for which a provision of £187 million had been charged in the prior period.

EEV non-operating items
Negative short-term fluctuations of £3,219 million primarily reflect lower than expected returns on equities and other investments held by the Group's US separate accounts and by the with-profits and unit-linked funds businesses in Asia and the UK. These negative effects have been partly offset by gains on equity derivatives held by the US business to manage market exposures arising from the guarantees provided on its annuity products.

Offsetting short-term fluctuations is a £146 million benefit from economic assumption changes, principally reflecting the impact of higher interest rates on the projected future fund growth rates for certain businesses written in Hong Kong and Singapore and the variable annuity business in the US. These projected higher growth rates increase fund values for policyholders and hence profitability for shareholders.

The loss attaching to corporate transactions of £451 million primarily relates to the reinsurance of the shareholder annuity portfolio to Rothesay Life. A more detailed explanation of this and other corporate transactions occurring in the period are set out in note 17 of the EEV financial statements.

Capital position, financing and liquidity

Capital position

Analysis of movement in Group shareholder Solvency II surplus[18]

	2018 £bn	2017 £bn
Solvency II surplus at 1 January	**13.3**	12.5
Operating experience	**4.2**	3.6
Non-operating experience (including market movements)	**(1.2)**	(0.6)
M&GPrudential transactions (see below)	**0.4**	-
Other capital movements:		
Net subordinated debt issuance (redemption)	**1.2**	(0.2)
Foreign currency translation impacts	**0.5**	(0.7)
Dividends paid	**(1.2)**	(1.2)
Model changes	**-**	(0.1)
Estimated Solvency II surplus at 31 December	**17.2**	13.3

The high quality and recurring nature of our operating capital generation and our disciplined approach to managing balance sheet risk has resulted in an increase in the Group's shareholders' Solvency II capital surplus[5] which is estimated at £17.2 billion at 31 December 2018 (equivalent to a solvency ratio of 232 per cent[6]), compared with £13.3 billion (202 per cent) at 31 December 2017. The increase in surplus was driven by operating capital formation of £4.2 billion and a £1.2 billion net increase in subordinated debt, offset by dividends to shareholders of £1.2 billion.

Local statutory capital
All of our subsidiaries continue to hold appropriate capital levels on a local regulatory basis. In the UK and Europe, at 31 December 2018 The Prudential Assurance Company Limited and its subsidiaries had an estimated Solvency II shareholder surplus[19] of £3.7 billion (equivalent to a cover ratio of 172 per cent), reflecting the impact from the reinsurance of £12 billion of annuity liabilities and the transfer of the Group's Hong Kong insurance subsidiaries. The UK with-profits surplus[20] is estimated at £5.5 billion (equivalent to a cover ratio of 231 per cent). In the US, operational capital formation and the strong performance of our hedging programme as equity markets weakened during the fourth quarter of 2018 more than offset remittances to Group and a 35 percentage point ratio impact from the incorporation of tax reform into the statutory capital requirement, resulting in a risk-based capital ratio of 458 per cent (2017: 409 per cent).

Debt portfolio
The Group continues to maintain a high-quality defensively positioned debt portfolio. Shareholders' exposure to credit is concentrated in the UK and Europe annuity portfolio and the US general account, mainly attributable to Jackson's fixed annuity portfolio. The credit exposure is well diversified and 98 per cent of our UK and Europe portfolio and 96 per cent of our US portfolio are investment grade[21]. During 2018, default losses were minimal and reported impairments across the UK and US portfolios were £4 million (2017: £2 million).

Financing and liquidity

Shareholders' net core structural borrowings and ratings

	2018 £m			2017 £m		
	IFRS basis	**Mark to market value**	**EEV basis**	**IFRS basis**	**Mark to market value**	**EEV basis**
Total borrowings of shareholder-financed businesses	**7,664**	**183**	**7,847**	6,280	743	7,023
Less: Holding company cash and short-term investments	**(3,236)**	**-**	**(3,236)**	(2,264)	-	(2,264)
Net core structural borrowings of shareholder-financed businesses	**4,428**	**183**	**4,611**	4,016	743	4,759
Gearing ratio*	**20%**			20%		

* Net core structural borrowings as proportion of IFRS shareholders' funds plus net debt, as set out in note III of the Additional unaudited IFRS financial information.

The Group had central cash resources of £3.2 billion at 31 December 2018 (31 December 2017: £2.3 billion). Total core structural borrowings increased by £1.4 billion, from £6.3 billion to £7.7 billion, mainly as a result of the capital rebalancing process related to the intended demerger of M&GPrudential. This involved the redemption of US$550 million (equivalent to £432 million at 31 December 2018) 7.75 per cent tier 1 perpetual subordinated debt in December 2018 being more than offset by the issue of US$500 million (£374 million at 31 December 2018) 6.5 per cent tier 2 substitutable subordinated notes, £500 million 6.25 per cent tier 2 substitutable subordinated notes and £750 million 5.625 per cent tier 2 substitutable subordinated notes in October 2018.

In addition to its net core structural borrowings of shareholder-financed businesses set out above, the Group also has access to funding via the money markets and has in place an unlimited global commercial paper programme. As at 31 December 2018, we had issued commercial paper under this programme totalling US$599 million, to finance non-core borrowings.

Prudential's holding company currently has access to £2.6 billion of syndicated and bilateral committed revolving credit facilities provided by 19 major international banks, expiring in 2023. Apart from small drawdowns to test the process, these facilities have never been drawn, and there were no amounts outstanding at 31 December 2018. The medium-term note programme, the US shelf programme (platform for issuance of SEC registered public bonds in the US market), the commercial paper programme and the committed revolving credit facilities are all available for general corporate purposes and to support the liquidity needs of Prudential's holding company, and are intended to maintain a flexible funding capacity.

Shareholders' funds

	IFRS		EEV	
	2018 £m	**2017 £m**	**2018 £m**	**2017 £m**
Profit after tax for the year[22]	**3,010**	2,389	**4,585**	8,750
Exchange movements, net of related tax	**348**	(409)	**1,706**	(2,045)
Cumulative exchange gain of Korea life business recycled to profit and loss account	**-**	(61)	**-**	-
Unrealised gains and losses on Jackson fixed income securities classified as available for sale[23]	**(1,083)**	486	**-**	-
Dividends	**(1,244)**	(1,159)	**(1,244)**	(1,159)
Mark to market value movements on Jackson assets backing surplus and required capital	**-**	-	**(95)**	40
Other	**131**	175	**132**	144
Net increase in shareholders' funds	**1,162**	1,421	**5,084**	5,730
Shareholders' funds at 1 January	**16,087**	14,666	**44,698**	38,968
Shareholders' funds at 31 December	**17,249**	16,087	**49,782**	44,698
Shareholders' value per share [7]	**665p**	622p	**1,920p**	1,728p
Return on shareholders' funds[7]	**25%**	25%	**17%**	17%

Group IFRS shareholders' funds at 31 December 2018 increased by 7 per cent to £17.2 billion (31 December 2017: £16.1 billion on an actual exchange rate basis), driven by the strength of the operating result, offset by dividend payments of £1,244 million. During the period, UK sterling has weakened relative to the US dollar and various Asian currencies. With approximately 51 per cent of the Group's IFRS net assets (74 per cent of the Group's EEV net assets) denominated in non-sterling currencies, this generated a positive exchange rate movement on the net assets in the period. In addition, the increase in US long-term interest rates between the start and the end of the reporting period produced unrealised losses on fixed income securities held by Jackson accounted through other comprehensive income.

The Group's EEV basis shareholders' funds also increased by 11 per cent to £49.8 billion (31 December 2017: £44.7 billion on an actual exchange rate basis), On a per share basis the Group's embedded value at 31 December 2018 equated to 1,920 pence, up from 1,728 pence at 31 December 2017.

Corporate transactions

Intention to demerge the Group's UK and Europe businesses and reinsurance of £12.0 billion[4] UK annuity portfolio

The Group is making good progress on its previously announced intention to demerge its UK and Europe businesses from Prudential plc, resulting in two separately listed companies. The Group has transferred legal ownership of The Prudential Assurance Company Limited (PAC) and M&G Group Limited to the new holding company for M&GPrudential, and completed the transfer of the legal ownership of its Hong Kong insurance subsidiaries from PAC to Prudential Corporation Asia Limited in December 2018.

In March 2018, M&GPrudential reinsured £12.0 billion (as at 31 December 2017) of its shareholder-backed annuity portfolio to Rothesay Life. Under the terms of the agreement, this is expected to be followed by a Part VII transfer of most of the portfolio by 30

June 2019. The reinsurance agreement became effective on 14 March 2018 and resulted in an IFRS basis pre-tax loss of £508 million.

The above transactions reduced the Group's EEV by £376 million which primarily reflects the loss of profits on the portion of the annuity liabilities reinsured and increased the Group's shareholder Solvency II capital position by £0.4 billion.

Prior to the demerger, the Group expects to rebalance its debt capital across Prudential and M&GPrudential. This will include the ultimate holding company of M&GPrudential becoming an issuer of new debt, including debt substituted from Prudential, and Prudential redeeming some of its existing debt. Following these actions, the overall absolute quantum of debt across Prudential and M&GPrudential is currently expected to increase, by an amount which is not considered to be material in the context of the Group's total outstanding debt as at 30 June 2018, before any substitutable debt had been issued, of £7.6 billion (comprising the Group's core structural borrowings of £6.4 billion and shareholder borrowings from short-term fixed income securities programme of £1.2 billion). At the time of the demerger, Prudential expects M&GPrudential to be holding around £3.5 billion of subordinated debt. This expectation is subject to the M&GPrudential capital risk appetite being approved by the Board of the ultimate holding company of M&GPrudential, once fully constituted to include independent non-executive directors, and reflects the current operating environment and economic conditions, material changes in which may lead to a different outcome.

Entrance into Thailand mutual fund market

In July 2018, Eastspring reached an agreement to acquire initially 65 per cent of TMB Asset Management Co., Ltd. (TMBAM), a leading asset management company in Thailand, from the TMB Bank Public Company Limited (TMB). Thailand is the largest fund management market within the Association of Southeast Asian Nations (ASEAN) with total assets under management of £115 billion at 31 December 2018[24]. Eastspring has an option to increase its ownership to 100 per cent in the future. As part of this acquisition, Eastspring has also entered into a distribution agreement with TMB to provide best-in-class investment solutions to their customers. The acquisition of TMBAM, with £9 billion of assets under management as at 31 December 2018, reinforces Prudential's commitment to the Thai market.

Acquisition of John Hancock's group payout annuity business

In November 2018, Jackson announced an agreement with John Hancock Life Insurance Company to reinsure 100 per cent of John Hancock's group payout annuity business, effective from 1 October 2018.

In total, the transaction involves Jackson indemnity reinsuring approximately US$5.5 billion of reserves, representing an increase in Jackson's general account liabilities of approximately 10 per cent. John Hancock will continue to be responsible for the administration of the business.

Renewal and expansion of regional strategic bancassurance alliance with UOB

In January 2019, Prudential and UOB renewed their regional bancassurance alliance until 2034, extending the scope to include a fifth market, Vietnam, alongside our existing footprint across Singapore, Malaysia, Thailand and Indonesia.

Under the terms of the renewal, Prudential's life insurance products will be distributed through UOB's extensive network of more than 400 branches in five markets, providing access to over four million UOB customers. In addition, Prudential will use its digital capabilities to deliver protection-focused propositions to aid UOB's digital bank expansion and customer acquisition aspirations. An initial fee of £662 million will be paid under the agreement which will be funded through internal resources. This amount will be paid in three instalments. £230 million was paid in February 2019 with £331 million to be paid in January 2020 and £101 million to be paid in January 2021.

Acquisition of majority stake in Group Beneficial

Prudential plc is acquiring a majority stake in Group Beneficial (Beneficial), one of the leading life insurers in Cameroon, Côte d'Ivoire and Togo. Beneficial provides savings and protection products to over 300,000 customers through 41 branches and more than 2,000 agents. The acquisition will significantly add to Prudential's growing scale in Africa, and is subject to various conditions and regulatory approvals.

Dividend

The Board has decided to increase the full-year ordinary dividend by 5 per cent to 49.35 pence per share, reflecting our 2018 financial performance and our confidence in the future prospects of the Group. In line with this, the Directors have approved a second interim ordinary dividend of 33.68 pence per share (2017: 32.5 pence per share).

The Group's dividend policy remains unchanged. The Board will maintain focus on delivering a growing ordinary dividend. In line with this policy, Prudential aims to grow the ordinary dividend by 5 per cent per annum. The potential for additional distributions will continue to be determined after taking into account the Group's financial flexibility across a broad range of financial metrics and an assessment of opportunities to generate attractive returns by investing in specific areas of the business[25].

Notes

1 Increase stated on a constant exchange rate basis.
2 For insurance operations, underlying free surplus generated represents amounts maturing from the in-force business during the period less investment in new business and excludes non-operating items. For asset management businesses, it equates to post-tax operating profit for the period. Restructuring costs are presented separately from the underlying business unit amount. Further information is set out in note 10 of the EEV basis results.
3 Core refers to the underlying profit of the UK and Europe insurance business, excluding the effect of, for example, management actions to improve solvency and material assumption changes. Details of these are set out in note I(d) of the Additional unaudited IFRS financial information.
4 Relates to IFRS shareholder annuity liabilities, valued as at 31 December 2017.
5 The Group shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring fenced with-profit funds and staff pension schemes in surplus. The estimated solvency positions include management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date, which for both 2018 and 2017 reflects the approved regulatory position.
6 Estimated before allowing for second interim ordinary dividend.
7 See note III of the Additional unaudited IFRS financial information for definition and reconciliation to IFRS balances.
8 Asia insurance revenues include spread income, fee income, with-profits, insurance margin and expected return on shareholder assets.
9 Margin represents operating income before performance-related fees as a proportion of the related funds under management, for further information see note I(c) of the additional unaudited IFRS financial information.
10 Includes Group's proportionate share of the liabilities and associated flows of the insurance joint ventures and associates in Asia.
11 Defined as movements in policyholder liabilities arising from premiums (net of charges), surrenders/withdrawals, maturities and deaths.
12 Includes unallocated surplus of with-profits business.
13 Includes Group's proportionate share in PPM South Africa and the Asia asset management joint ventures.
14 For our asset management business, the level of funds managed on behalf of third parties, which are not therefore recorded on the balance sheet, is a driver of profitability. We therefore analyse the movement in the funds under management each period, focusing between those which are external to the Group and those held by the insurance business and included on the Group balance sheet. This is analysed in note II(b) of the Additional unaudited IFRS financial information.
15 Net inflows exclude Asia Money Market Fund (MMF) inflows of £1,500 million (2017: £1,495 million). External funds under management exclude Asia MMF balances of £11,602 million (2017: £9,317 million).
16 Represents M&GPrudential asset management external funds under management and internal funds included on the M&GPrudential long-term insurance business balance sheet.
17 Net cash remitted by business units are included in the Holding company cash flow, which is disclosed in detail in note II(a) of the Additional unaudited IFRS financial information. This comprises dividends and other transfers from business units that are reflective of emerging earnings and capital generation.
18 The methodology and assumptions used in calculating the Solvency II capital results are set out in note II(c) of the Additional unaudited IFRS financial information.
19 The UK shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring-fenced with-profit funds and staff pension schemes in surplus. The estimated solvency positions include management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date, which for both 2018 and 2017 reflects the approved regulatory position.
20 The estimated solvency positions include management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date, which for both 2018 and 2017 reflects the approved regulatory position.
21 Based on hierarchy of Standard and Poor's, Moody's and Fitch, where available and if unavailable, internal ratings have been used.
22 Excluding profit for the year attributable to non-controlling interests.
23 Net of related charges to deferred acquisition costs and tax.
24 ©Copyright 2018 Strategic Insight, an Asset International Company and when referenced or sourced Morningstar Inc., Standard & Poor's Inc., and Lipper Inc. All rights reserved. The information, data, analyses and opinions contained herein (a) include confidential and proprietary information of the aforementioned companies, (b) may not be copied or redistributed for any purpose, (c) are provided solely for information purposes, and (d) are not warranted or represented to be correct, complete, accurate, or timely.
25 Refer to note 11 on the parent company financial statements for further detail on the distributable profits of Prudential plc.

Group Chief Risk Officer’s report of the risks facing our business and how these are managed

Our Group Risk Framework and risk appetite have allowed us to control our risk exposure successfully throughout the year. Our governance, processes and controls enable us to deal with uncertainty effectively, which is critical to the achievement of our strategy of helping our customers achieve their long-term financial goals.

This section explains the main risks inherent in our business and how we manage those risks, with the aim of ensuring an appropriate risk profile is maintained.

1. Introduction

Group structure
In August 2017 the Group announced its intention to combine M&G and its UK and Europe life business to form M&GPrudential, allowing the scale and capabilities in these businesses to be leveraged more effectively. In March 2018, the intention to demerge M&GPrudential from the rest of the Group was announced, with the aim of focusing on meeting customers’ rapidly evolving needs and to deliver enhanced long-term value to investors as two separate businesses.

The merger activity ongoing at M&GPrudential and its planned separation from the rest of the Group requires significant and complex changes and these have been progressing apace throughout 2018. The Group Risk function is embedded within key work streams and a clear view exists of the objectives, risks and dependencies involved in order to execute this change agenda. A mature and well-embedded risk framework is in place and, during this period of transition, the Group Risk function has a defined role in providing oversight, support and risk management, as well as providing objective challenge to ensure the Group remains within its risk appetite. During 2018 these activities have been in the form of risk opinions, guidance and assurance on critical transformation and demerger activity, as well as assessments of the financial risks to the execution of the demerger under various stress scenarios. A key objective is that post demerger there are two strong, standalone risk functions in M&GPrudential and Prudential plc, with operational separation planning for the risk functions remaining on track.

Societal developments
Focus in western economies continues to shift from the goods and services which businesses deliver to customers towards the way in which such business is conducted and how this impacts on the wider society. Stakeholder and regulatory expectations of the Group’s environmental, social and governance (ESG) activities are also increasing. In undertaking its business, the Group actively considers the ESG implications of its activities. Recent regulatory developments such as the EU General Data Protection Regulation (GDPR) have underlined that personal data must be held securely and its use must be transparent to the data owner. Risks around the security and use of personal data are actively managed by the Group, and the recent regulatory changes in data protection in the US and Europe have been incorporated into the principles against which the business requirements are defined.

The world economy
The beginning of 2018 saw strong and broad economic growth following the significant US tax reforms enacted toward the end of 2017. As the year progressed the global economic backdrop evolved and a divergence in growth between the US and the rest of the world was observed. Rising US policy rates, tightening financial conditions and increasing trade tensions raised concerns and impacted emerging markets in particular. In the fourth quarter, fears of a more pronounced global economic slowdown also impacted the US as reductions in monetary stimulus continued, contributing to a sharp shift in risk sentiment. At the start of 2019, the outlook for the global economy remains uncertain and while growth remains positive, it has become more fragile and risks are weighted towards the downside. Political tensions in Europe, including uncertainty surrounding the nature of the UK’s exit from the EU and its future trading relationship, geopolitical developments and the potential increase of international trade tensions between the US and China pose risks to global growth and the economic environment.

Financial markets
Financial markets faced a number of headwinds in 2018 and asset valuations suffered broadly amid the re-emergence of market volatility. Global markets, and emerging markets in particular, faced broad pressure throughout the year. US markets, however, proved resilient until the fourth quarter when fears of an economic slowdown triggered a sharp sell-off in equities. In parallel, credit spreads also widened as the position of the credit cycle became a key concern for market participants. Across the world, interest rates movements were mixed over the year, although there has been a notable broad flattening of the yield curve in the US, impacted by changes in growth and inflation data, risk sentiment and increased concerns of a possible recession. Financial markets remain particularly vulnerable to further abrupt changes in sentiment, and in particular if the risks to the global economy noted above were to materialise.

Political landscape
Events in the past year continue to indicate that the world is in a period of global geopolitical transition and increasing uncertainty. Popular discontent remains one of the driving factors of political change, and the liberal norms and the role of multilateral rules-based institutions that underpin global order, such as the United Nations (UN), the North Atlantic Treaty Organisation (NATO) and the World Trade Organisation (WTO), appear to be evolving. Across the Group’s key geographies we have increasingly seen national protectionism in trade and economic policies. The UK’s exit from the EU and the nature of the future relationship remains a key political uncertainty. As a global organisation, we develop plans to mitigate business risks arising from this shift and engage with national bodies where we can in order to ensure our policyholders are not adversely impacted. It is clear, however, that the full long-term impacts of these changes remain to be seen.

Regulations
Prudential operates in highly regulated markets across the globe, and the nature and focus of regulation and laws remains fluid. A number of national and international regulatory developments are in progress, with a continuing focus on solvency and capital standards, conduct of business, systemic risks and macro-prudential policy. Such developments will continue to be monitored at a national and global level and form part of Prudential's engagement with government policy teams and regulators. The Group announced in August 2018 that the Hong Kong Insurance Authority would be the Group-wide supervisor after the demerger of M&GPrudential, and constructive engagement on the future Group-wide regulatory framework, led by the Group Chief Risk Officer, will continue in 2019.

2. Key internal, regulatory, economic and (geo)political events over the past 12 months

Q1 2018	Q2 2018	Q3 2018	Q4 2018
In March 2018 the intention to demerge M&GPrudential from the rest of the Group is announced. £12 billion of annuity liabilities in UK and Europe business are reinsured to Rothesay Life Plc. A Part VII transfer of most of the portfolio is expected to be completed by 30 June 2019. Eastspring becomes the third Prudential signatory, after M&G and PPM South Africa (PPMSA), to the UN Principles for Responsible Investment in February 2018. President Xi Jinping enters a second term in office in China after election by the National People's Congress in March 2018. A coalition government is formed in Italy between the centre right League and anti-establishment Five Star Movement, after general elections in March 2018. The US administration proposes initial trade tariff measures (with additional proposals announced over H1 2018), raising trade tensions with its key G7 partners and China. US equity markets decline rapidly, triggering a global sell-off, with the Dow Jones Industrial Average falling by circa 3,000 points in just two weeks. US markets rebound over the second and third quarters.	The General Data Protection Regulation (GDPR) goes live in the EU on 25 May 2018, increasing the rights of individuals over the use of their personal information by companies. The US Department of Labor's (DoL's) fiduciary rule is effectively ended after a decision in the US courts in March 2018. The deadline for the DoL to appeal lapses in June. Other proposals, such as the US Securities and Exchanges Commission's best interest standard, remain in progress. US President Trump and North Korean Chairman Kim Jong Un meet in Singapore on 12 June 2018 for a historic summit, where denuclearisation of the Korean peninsula is discussed. The opposition Pakatan Harapan coalition win power in Malaysia following general elections held in May 2018. The 22nd round of talks on the Regional Comprehensive Economic Partnership (RCEP) are held in Singapore between 28 April and 8 May 2018, the goal being to create the world's largest economic bloc. Negotiations continue into 2019. The Indonesia President approves regulations on 'grandfathering' foreign ownership of insurance companies.	In August the Group announces that the Hong Kong Insurance Authority will become the Group-wide supervisor for Prudential plc after the demerger of M&GPrudential, and constructive engagement on the future regulatory relationship begins. In July the International Association of Insurance Supervisors (IAIS) releases consultation documents for both the Common Framework for the Supervision of Insurers (ComFrame) and Insurance Capital Standard (ICS) v2.0. The Group submits ICS field results to the PRA in August 2018. In September, the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) request from major banks and insurers, details of preparations and actions being undertaken to manage transition from London Inter-Bank Offered Rate (LIBOR) to alternative interest rate benchmarks. The Bank of England raises rates for the second time since the 2008 financial crisis to 0.75 per cent in August, while highlighting significant Brexit-driven uncertainties to the economy. The US imposes tariffs on Chinese exports worth US$50 billion in July, prompting Beijing to respond in kind. Despite a temporary truce agreed at the G20 summit on 1 December, trade tensions between the two nations remains high. Emerging market equities decline rapidly in August as tightening financial conditions impact economies with external funding vulnerabilities.	In November, Jackson announces the acquisition of the group payout annuity business of John Hancock Life Insurance Company, a closed book of circa 200,000 in-force certificates representing IFRS reserves of approximately US$5.5bn. PPM America (PPMA) becomes the fourth Prudential signatory to the UN Principles for Responsible Investment in October 2018. The IAIS launches a consultation for the Holistic Framework (HF) in November, which aims to asses and mitigate systemic risk in the insurance sector and is intended to replace the current Global Systemically Important Insurer (G-SII) measures, with the aim of adoption in November 2019. In November the International Accounting Standards Board (IASB) tentatively delays the effective date of IFRS 17 by one year to periods beginning on or after 1 January 2022. The introduction of further amendments to this new standard will be considered. Democrats win control of the House of Representatives in the November US midterm elections, while the Republicans retain control of the Senate. As bipartisan disputes increase, the US government partially shuts down between late December 2018 and January 2019. In December, the UK Parliament rejects the negotiated agreement on the UK's withdrawal from the EU. Uncertainty on the nature of the UK's exit from the EU persists as the UK government seeks to renegotiate the agreement in early 2019. The reduction in global accommodative monetary policy continues, with the European Central Bank (ECB) confirming that net asset purchases would cease at the end of 2018, and the US Federal reserve raises rates for the fourth time in 2018 in December. China reports a large manufacturing decline in December, prompting concerns of a global growth slowdown. Additional stimulus measures from the People's Bank of China are enacted. Fears of tightening financial conditions and a global economic slowdown trigger a sharp sell-off in US equity markets, which had remained resilient through the first three quarters of 2018, while global equities fall further. The S&P500 ends 2018 with an annual decline of circa 6 per cent. In early 2019 risk sentiment improves, contributing to a broad rally in equity markets.

3. Managing the risks in implementing our strategy

This section provides an overview of the Group's strategy, the significant risks arising from the delivery of this strategy and the risk management focus for the following 12 months. The risks outlined below, which are not exhaustive, are discussed in more detail in sections 5 and 6.

Our strategy	Significant risks arising from the delivery of the strategy	Risk management focus for the next 12 months
Asia *Serving the protection and investment needs of the growing middle class in Asia*	• Persistency risk	• Implementation of business initiatives to manage persistency risk, including review of distribution channels and incentive structures. Ongoing experience monitoring.
	• Morbidity risk	• Implementation of business initiatives to manage morbidity risk, including product repricing where required. Ongoing experience monitoring.
	• Regulatory risk, including foreign ownership	• Proactive engagement with national governments and regulators.
United States *Providing asset accumulation and retirement income products to US baby boomers;*	• Financial risks	• Maintaining, and enhancing where necessary, appropriate risk limits, hedging strategies and Group oversight that are in place.
	• Policyholder behaviour risk	• Continued monitoring of policyholder behaviour experience and review of assumptions.
Africa	• The Group will continue to increase its risk management focus on Prudential Africa as the business there grows in materiality.	
UK and Europe *Meeting the savings and retirement needs of an ageing UK and continental European population*	• M&GPrudential merger and transformation risk	• Managing the merger and transformation risks to the delivery of strategic, financial and operational objectives.
	• Longevity risk	• Continued oversight and experience analysis.
	• Customer risk	• Ongoing monitoring of embedded customer outcome indicators. • Managing the customer risk implications from: merger and transformation activity; new product propositions and new regulatory requirements.
Group-wide *We aim to generate attractive returns enabling us to provide financial security to our customers and deliver sustainable growth for our shareholders. Following rigorous review, we believe that this long-term strategy is best served through the demerger of M&GPrudential.*	• Transformation risks around key change programmes	• Managing the inter-connected execution risks from this transformation activity under the Group's transformation risk framework, as well as providing other risk management support and review. • Ensuring both M&GPrudential and Prudential plc will have in place two strong standalone risk functions after demerger.
	• Group-wide regulatory risks	• Engagement with regulators and industry groups on macro-prudential and systemic risk-related regulatory initiatives, international capital standards, and other initiatives with Group-wide impacts. • Engagement with the Hong Kong Insurance Authority on the Group-wide supervisory framework that will apply to the Group after the demerger of M&GPrudential.
	• Information security and data privacy risks	• Continuing the implementation of the Group's information security risk management strategy and defence plan. • Ensuring full compliance with applicable privacy laws across the Group.

4. Risk governance

a. System of governance

Appropriately managed risks allow Prudential to take business opportunities and enable the growth of its business. Effective risk management is therefore fundamental in the execution of the Group's business strategy. Prudential's approach to risk management must be both well embedded and rigorous, and, as the economic and political environment in which we operate changes, it should also be sufficiently broad and dynamic to respond to these changes.

Prudential has in place a system of governance that promotes and embeds a clear ownership of risk, processes that link risk management to business objectives, a proactive Board and senior management providing oversight of risks, mechanisms and methodologies to review, discuss and communicate risks, and risk policies and standards to ensure risks are identified, measured, managed, monitored and reported.

How 'risk' is defined

Prudential defines 'risk' as the uncertainty that is faced in implementing the Group's strategies and achieving its objectives successfully, and includes all internal or external events, acts or omissions that have the potential to threaten the success and survival of the Group. Accordingly, material risks will be retained selectively when it is considered that there is value in doing so, and where it is consistent with the Group's risk appetite and philosophy towards risk-taking.

How risk is managed

Risk management is embedded across the Group through the Group Risk Framework, which details Prudential's risk governance, risk management processes and risk appetite. The Framework has been developed to monitor the risks to our business and is owned by the Board. The aggregate Group exposure to its key risk drivers is monitored and managed by the Group Risk function which is responsible for reviewing, assessing, providing oversight and reporting on the Group's risk exposure and solvency position from the Group economic, regulatory and ratings perspectives.

In 2018 the Group continued to update its policies and processes around new product approvals, management of critical third-party arrangements and oversight of model risks. A transformation risk framework is being applied directly to manage programme delivery risks. Prudential manages key ESG issues though a multi-disciplinary approach with first line functional ownership for ESG topics.

The following section provides more detail on our risk governance, risk culture and risk management process.

b. Group Risk Framework

i. Risk governance and culture

Prudential's risk governance comprises the Board, organisational structures, reporting relationships, delegation of authority, roles and responsibilities, and risk policies that the Group Head Office and the business units establish to make decisions and control their activities on risk-related matters. It includes individuals, Group-wide functions and committees involved in overseeing and managing risk.

The risk governance structure is led by the Group Risk Committee, supported by independent non-executives on risk committees of Material Subsidiaries. These committees monitor the development of the Group Risk Framework, which includes risk appetite, limits, and policies, as well as risk culture.

The Group Risk Committee reviews the Group Risk Framework and recommends changes to the Board to ensure that it remains effective in identifying and managing the risks faced by the Group. A number of core risk policies and standards support the Framework to ensure that risks to the Group are identified, assessed, managed and reported.

Culture is a strategic priority of the Board, who recognise its importance in the way that the Group does business. Risk culture is a subset of Prudential's broader organisational culture, which shapes the organisation-wide values that we use to prioritise risk management behaviours and practices.

An evaluation of risk culture forms part of the Group Risk Framework and in particular seeks to identify evidence that:

- Senior management in business units articulate the need for effective risk management as a way to realise long-term value and continuously support this through their actions;
- Employees understand and care about their role in managing risk – they are aware of and discuss risk openly as part of the way they perform their role; and
- Employees invite open discussion on the approach to the management of risk.

The Group Risk Committee also has a key role in providing advice to the Remuneration Committee on risk management considerations to be applied in respect of executive remuneration.

Prudential's Code of Conduct and Group Governance Manual include a series of guiding principles that govern the day-to-day conduct of all its people and any organisations acting on its behalf. This is supported by specific risk policies which require that the Group act in a responsible manner. This includes, but is not limited to, policies on anti-money laundering, financial crime and anti-bribery and corruption. The Group's third-party supply policy ensures that human rights and modern slavery considerations are embedded across all of its supplier and supply chain arrangements. Embedded procedures to allow individuals to speak out safely and anonymously against unethical behaviour and conduct are also in place.

ii. The risk management cycle

The risk management cycle comprises processes to identify; measure and assess; manage and control; and monitor and report on our risks.

Risk identification

Group-wide risk identification takes place throughout the year as the Group's businesses undertake a comprehensive bottom-up process to identify, assess and document its risks. This concludes with an annual top-down identification of the Group's key risks, which considers those risks that have the greatest potential to impact the Group's operating results and financial condition and is used to inform risk reporting to the risk committees and the Board for the year.

Our risk identification process also includes the Group's Own Risk and Solvency Assessment (ORSA), as required under Solvency II, and horizon-scanning performed as part of our emerging risk management process.

In accordance with provision C.2.1 of the UK Code, the Directors perform a robust assessment of the principal risks facing the Company through the Group-wide risk identification process, Group ORSA report and the risk assessments undertaken as part of the business planning review, including how they are managed and mitigated.

Reverse stress testing, which requires the Group to ascertain the point of business model failure, is another tool that helps us to identify the key risks and scenarios that may have a material impact on the Group.

The risk profile is a key output from the risk identification and risk measurement processes, and is used as a basis for setting Group-wide limits, management information, assessment of solvency needs, and determining appropriate stress and scenario testing. The Group's annual set of key risks are given enhanced management and reporting focus.

Risk measurement and assessment

All identified risks are assessed based on an appropriate methodology for that risk. All quantifiable risks, which are material and mitigated by holding capital, are modelled in the Group's internal model, which is used to determine capital requirements under Solvency II and our own economic capital basis. Governance arrangements are in place to support the internal model, including independent validation and processes and controls around model changes and limitations.

Risk management and control

The control procedures and systems established within the Group are designed to manage the risk of failing to meet business objectives and are detailed in the Group risk policies. These focus on aligning the levels of risk-taking with the achievement of business objectives and can only provide reasonable, and not absolute assurance, against material misstatement or loss.

The management and control of risks are set out in the Group risk policies, and form part of the holistic risk management approach under the Group's ORSA. These risk policies define:

- The Group's risk appetite in respect of material risks, and the framework under which the Group's exposure to those risks is limited;
- The processes to enable Group senior management to effect the measurement and management of the Group material risk profile in a consistent and coherent way; and
- The flows of management information required to support the measurement and management of the Group's material risks and to meet the needs of external stakeholders.

The methods and risk management tools we employ to mitigate each of our major categories of risks are detailed in the further risk information section below.

Risk monitoring and reporting

The identification of the Group's key risks informs the management information received by the Group risk committees and the Board. Risk reporting of key exposures against appetite is also included, as well as ongoing developments in other key and emerging risks.

iii. Risk appetite, limits and triggers

The extent to which Prudential is willing to take risk in the pursuit of its business strategy and objective to create shareholder value is defined by a number of qualitative and quantitative expressions of risk appetite, operationalised through measures such as limits, triggers and indicators. The Group Risk function is responsible for reviewing the scope and operation of these risk appetite measures at least annually to determine that they remain relevant. The Board approves all changes made to the Group's aggregate risk appetite, and has delegated authority to the Group Risk Committee to approve changes to the system of limits, triggers and indicators.

Group risk appetite is set with reference to economic and regulatory capital, liquidity and earnings volatility which is aimed at ensuring that an appropriate level of aggregate risk is taken. Appetite is also defined for the Group's financial and non-financial risks. Further detail is included in sections 5 and 6, as well as covering risks to shareholders, including those from participating and third-party business. Group limits operate within these expressions of risk appetite to constrain material risks, while triggers and indicators provide further constraint and defined points for escalation.

Capital requirements:

Limits on capital requirements aim to ensure that the Group meets its internal economic capital requirements, achieves its desired target rating to meet its business objectives, and ensures that supervisory intervention is not required. The two measures used at the Group level are Solvency II capital requirements and internal economic capital (ECap) requirements. In addition, capital requirements are monitored on local statutory bases.

The Group Risk Committee is responsible for reviewing the risks inherent in the Group's business plan and for providing the Board with input on the risk/reward trade-offs implicit therein. This review is supported by the Group Risk function, which uses submissions from our local business units to calculate the Group's aggregated position (allowing for diversification effects between local business units) relative to the aggregate risk limits.

Liquidity:
The objective of the Group's liquidity risk appetite is to ensure that the Group is able to generate sufficient cash resources to meet financial obligations as they fall due in business-as-usual and stressed scenarios. Risk appetite with respect to liquidity risk is measured using a Liquidity Coverage Ratio (LCR) which considers the sources of liquidity against liquidity requirements under stress scenarios.

Earnings volatility:
The objectives of the Group's appetite and aggregate risk limits on earnings volatility seek to ensure that variability is consistent with the expectations of stakeholders; that the Group has adequate earnings (and cash flows) to service debt and expected dividends and to withstand unexpected shocks; and that earnings (and cash flows) are managed properly across geographies and are consistent with funding strategies. The volatility of earnings is measured and monitored on operating profit and EEV operating profit bases, although IFRS and EEV total profits are also considered.

5. Summary risks

Broadly, the risks assumed across the Group can be categorised as those which arise as a result of our business operations, our investments and those arising from the nature of our products. Prudential is also exposed to those broad risks which apply because of the global environment in which it operates. These risks, where they materialise, may have a financial impact on the Group, and could also impact on the performance of its products or the services it provides to our customers and distributors, which gives rise to potential risks to its brand and reputation and have conduct risk implications. These risks are summarised below. The materiality of these risks, whether material at the level of the Group or its business units, is also indicated. The Group's disclosures covering risk factors can be found at the end of this document.

'Macro' risks

Some of the risks that the Group is exposed to are necessarily broad given the external influences which may impact on the business. These risks include:

Global economic conditions
Changes in global economic conditions can impact Prudential directly; for example, by leading to poor investment returns and fund performance, and increasing the cost of promises (guarantees) that have been made to our customers. Changes in economic conditions can also have an indirect impact on the Group; for example, leading to a decrease in the propensity for people to save and buy Prudential's products, as well as changing prevailing political attitudes towards regulation. This is a risk which is considered material at the level of the Group.

Geopolitical risk
The geopolitical environment may have direct or indirect impacts on the Group, and has seen varying levels of volatility in recent years as seen by political developments in the UK, the US and the Eurozone. Uncertainty in these regions, combined with continuing conflict in the Middle East and elevated tensions in East Asia and the Korean peninsula underline that geopolitical risks have potentially global and wide-ranging impacts; for example, through increased regulatory and operational risks, and changes to the economic environment.

Regulatory risk
Prudential operates under the ever-evolving requirements set out by diverse regulatory, legal and tax regimes. The increasing shift towards macro-prudential regulation and the number of regulatory changes under way across Asia (in particular focusing on consumer protection) are key areas of focus, while both Jackson and M&GPrudential operate in highly regulated markets. Regulatory reforms can have a material impact on Prudential's businesses. The proposed demerger of M&GPrudential will result in a change in Prudential's Group-wide supervisor to the Hong Kong Insurance Authority. The Group is, led by the Group Chief Risk Officer, proactively engaging with the supervisor-elect on the supervisory framework that will apply to the Group after the demerger.

Technological change
The emergence of advanced technologies such as artificial intelligence and blockchain is providing an impetus for companies to rethink their existing operating models and how they interact with their customers. Technological change is considered from both an external and internal view. The external view considers the rise of new technologies and how this may impact on the insurance industry and Prudential's competitiveness within it, while the internal view considers the risks associated with the Group's internal developments in meeting digital change challenges and opportunities. Prudential is embracing the opportunities from new technologies, and any risks which arise from them are closely monitored.

ESG risks
As a Group, responding effectively to those material risks with ESG implications is crucial in maintaining Prudential's brand and reputation, and in turn its financial performance and its long-term strategy. Further information on the Group's approach to governance on ESG issues and the relevant Group-wide policies for managing these are included in the Corporate responsibility review.

Risks from our investments	Risks from our products	Risks from our business operations

Risks from our investments

Market risk
Is the potential for reduced value of Prudential's investments resulting from the volatility of asset prices, driven by fluctuations in equity prices, interest rates, foreign exchange rates and property prices.

In the Asia business, the main market risks arise from the value of fees from its fee-earning products. In the US, Jackson's fixed and variable annuity books are exposed to a variety of market risks due to the assets backing these policies.

The UK business' market risk exposure arises from the valuation of the shareholder's proportion of the with-profits fund's future profits, which depends on equity, property and bond values.

M&GPrudential invests in a broad range of asset classes and its income is subject to the price volatility of global financial and currency markets.

Credit risk
Is the potential for reduced value of Prudential's investments driven by the market's perceptions for potential for defaults of investment and other counterparties.

The Group's asset portfolio also gives rise to invested credit risk. The assets backing the UK and Jackson annuity businesses means credit risk is considered a material risk for these business units in particular.

Liquidity risk
Is the risk of not having sufficient liquid assets to meet obligations as they fall due, and we look at this under both normal and stressed conditions. This is a risk which is considered material at the level of the Group.

Risks from our products

Insurance risks
The nature of the products offered by Prudential exposes it to insurance risks, which form a significant part of the overall Group risk profile.

The insurance risks that the business is exposed to by virtue of its products include **longevity risk** (policyholders living longer than expected); **mortality risk** (higher number of policyholders with life protection dying than expected); **morbidity risk** (more policyholders with health protection becoming ill than expected) and **persistency risk** (more customers lapsing their policies than expected, and a type of policyholder behaviour risk). The medical insurance business in Asia is also exposed to **medical inflation risk** (the increasing cost of medical treatments being higher than expected).

The pricing of Prudential's products requires it to make a number of assumptions, and deviations from these may impact its reported profitability and capital position. Across its business units, some insurance risks are more material than others.

Persistency and morbidity risks are among the most material insurance risks for the Asia business given the focus on health and protection products in the region.

For M&GPrudential the most material insurance risk is longevity risk, arising from its legacy annuity business.

The Jackson business is most exposed to policyholder behaviour risk, including persistency, which impacts the profitability of the variable annuity business and is influenced by market performance and the value of policy guarantees.

Conduct risk
The design and distribution of Prudential's products is crucial in ensuring that the Group's commitment to meeting customers' needs and expectations are met, and are factors which the Group considers as part of its overall conduct of business.

Risks from our business operations

Strategic and transformation risks
A number of significant change programmes are currently running to effect both the Group's strategy and to comply with emerging regulatory changes. The breadth of these activities, and the consequences, including the reputational impact, to the Group should they fail to meet their objectives, mean that these risks are material at the level of the Group.

Operational risks
A combination of the complexity of the Group, its activities and the extent of transformation in progress creates a challenging operating environment.

Operational risk is the risk of loss or unintended gain from inadequate or failed processes, personnel, systems and external events, and can arise through business transformation; introducing new products; new technologies; and entering into new markets and geographies. Implementing the business strategy and processes for ensuring regulatory compliance (including those relating to the conduct of its business) requires interconnected change initiatives across the Group, the pace of which introduces further complexity. The Group's outsourcing and third party relationships introduce their own distinct risks. Such operational risks, if they materialise, could result in financial loss and/or reputational damage. Operational risk is considered to be material at the level of the Group.

Business disruption risks may impact on Prudential's ability to meet its key objectives and protect its brand and reputation. The Group's business resilience is a core part of a well embedded business continuity management programme.

Information security and data privacy risks are significant considerations for Prudential and the cyber security threat continues to evolve globally in sophistication and potential significance. This includes the continually evolving risk of malicious attack on its systems, network disruption as well as risks relating to data security, integrity, privacy and misuse. The scale of the Group's IT infrastructure and network, stakeholder expectations and high profile cyber security and data misuse incidents across industries means that these risks continue to be considered material at the level of the Group.

6. Further risk information

In reading the sections below, it is useful to understand that there are some risks that Prudential's policyholders assume by virtue of the nature of their products, and some risks that the Company and its shareholders assume. Examples of the latter include those risks arising from assets held directly by and for the Company or the risk that policyholder funds are exhausted. This report is focused mainly on risks to the shareholder but will include those which arise indirectly through our policyholder exposures.

6.1 'Macro' risks

a. Global regulatory and political risks

Regulatory and political risks may impact on Prudential's business or the way in which it is conducted. This covers a broad range of risks including changes in government policy and legislation, capital control measures, new regulations at either national or international level, and specific regulator interventions or actions. Following the announcement in August 2018 that the Hong Kong Insurance Authority would become Prudential's Group-wide supervisor after the demerger of M&GPrudential, constructive engagement with the supervisor-elect began in 2018 and will continue into 2019. In particular, Prudential continues to engage with the supervisor on its proposed Group-wide supervision framework which will apply to the Group after the demerger.

Recent shifts in the focus of some governments toward more protectionist or restrictive economic and trade policies could impact on the degree and nature of regulatory changes and Prudential's competitive position in some geographic markets. This could take effect, for example, through increased friction in cross-border trade, capital controls or measures favouring local enterprises such as changes to the maximum level of non-domestic ownership by foreign companies. These developments continue to be monitored by the Group at a national and global level and these considerations form part of the Group's ongoing engagement with government policy teams and regulators.

Efforts to curb systemic risk and promote financial stability are also underway. At the international level, the Financial Stability Board (FSB) continues to develop recommendations for the asset management and insurance sectors, including on-going assessment of systemic risk measures. The International Association of Insurance Supervisors (IAIS) has continued its focus on the following two key developments.

Prudential's designation as a G-SII was last reaffirmed on 21 November 2016. The FSB, in conjunction with the IAIS, did not publish a new list of G-SIIs in 2017 and did not engage in G-SII identification for 2018 following IAIS' launch of the consultation on the Holistic Framework (HF) on 14 November 2018, which aims to assess and mitigate systemic risk in the insurance sector and is intended to replace the current G-SII measures. The IAIS intends to implement the HF in 2020 and it is proposed that G-SII identification be suspended from that year. In the interim, the relevant group-wide supervisors have committed to continue applying existing enhanced G-SII supervisory policy measures with some supervisory discretion, which includes a requirement to submit enhanced risk management plans. In November 2022, the FSB will review the need to either discontinue or re-establish an annual identification of G-SIIs in consultation with the IAIS and national authorities. The Higher Loss Absorbency (HLA) standard (a proposed additional capital measure for G-SII designated firms, planned to apply from 2022) is not part of the proposed HF. However, the HF proposes more supervisory powers of intervention for mitigating systemic risk, including temporary financial reinforcement measures such as capital add-ons and suspension of dividends.

The IAIS is also developing the ICS as part of ComFrame – the Common Framework for the supervision of Internationally Active Insurance Groups (IAIGs). The implementation of ICS will be conducted in two phases – a five-year monitoring phase followed by an implementation phase. ComFrame will more generally establish a set of common principles and standards designed to assist supervisors in addressing risks that arise from insurance groups with operations in multiple jurisdictions. The ComFrame proposals, including ICS, could result in enhanced capital and regulatory measures for IAIGs, for which Prudential satisfies the criteria.

In certain jurisdictions in which Prudential operates there are also a number of ongoing policy initiatives and regulatory developments that are having, and will continue to have, an impact on the way Prudential is supervised, including the US Dodd-Frank Wall Street Reform and Consumer Protection Act, addressing Financial Conduct Authority (FCA) reviews and ongoing engagement with the Prudential Regulation Authority (PRA). Decisions taken by regulators, including those related to solvency requirements, corporate or governance structures, capital allocation and risk management may have an impact on our business.

There has, in recent years, been regulatory focus in the UK on insurance products and market practices which may have adversely impacted customers, including the FCA's Legacy Review and Thematic Review of Annuity Sales Practices. The management of customer risk remains a key focus of management in the UK business. Merger and transformation activity at M&GPrudential, new product propositions and new regulatory requirements may also have customer risk implications which are monitored.

In May 2017, the International Accounting Standards Board (IASB) published IFRS 17 which will introduce fundamental changes to the IFRS-based reporting of insurance entities that prepare accounts according to IFRS from 2021. In November 2018, the IASB tentatively agreed to delay the effective date of IFRS 17 by one year to periods beginning on or after 1 January 2022 and is considering introducing further amendments to this new standard. IFRS 17 is expected to, among other things, include altering the timing of IFRS profit recognition, and the implementation of the standard is likely to require changes to the Group's IT, actuarial and finance systems. The Group is reviewing the complex requirements of this standard and considering its potential impact.

In March 2018, the UK and EU agreed the terms of a transition agreement for the UK's exit from the bloc, which will last from the termination of the UK's membership of the EU (at 11.00pm GMT 29 March 2019) until 31 December 2020 (although a legally binding text is yet to be agreed). The outcome of negotiations on the final terms of the UK's relationship with the EU remains highly uncertain. In particular, depending on the nature of the UK's exit from the EU, the following effects may be seen. The UK and EU may experience a downturn in economic activity, which is expected to be more pronounced for the UK, particularly in the event of a disorderly exit by the UK from the EU. Market volatility and illiquidity may increase in the period leading up to, and following, the UK's withdrawal, and property values (including the liquidity of property funds, where redemption restrictions may be applied) and interest rates may be impacted. In particular, downgrades in sovereign and corporate debt ratings may occur. In a severe scenario where the UK's sovereign rating is downgraded by more than one notch, this may also impact on the credit ratings of UK companies, including M&GPrudential's UK business. The legal and regulatory regime in which the Group (and, in particular, M&GPrudential) operates, may also be affected (including, the future applicability of the Solvency II regime in the UK), the extent of which remains uncertain. There is also a risk of operational disruption to the business, in particular to M&GPrudential.

The Group's diversification by geography, currency, product and distribution should reduce some of the potential impact of the UK's exit. M&GPrudential, due to the geographical location of both its businesses and its customers, has the most potential to be affected. As a result of the uncertainty on the nature of the arrangements that will be put in place between the UK and the EU, M&GPrudential has completed the implementation of a range of plans including transfers of business to EU jurisdictions, balance sheet and with-profits fund hedging protection and operational measures (including customer communications) that are designed to mitigate the potential adverse impacts to the Group's UK business. In addition, the business has sought to ensure, through various risk mitigation actions, that it is appropriately prepared for the potential operational and financial impacts of a no-deal withdrawal.

In the US, various initiatives are underway to introduce fiduciary obligations for distributors of investment products, which may reshape the distribution of retirement products. Jackson has introduced fee-based variable annuity products in response to the potential introduction of such rules, and we anticipate that the business's strong relationships with distributors, history of product innovation and efficient operations should further mitigate any impacts.

In late 2018, the US NAIC concluded an industry consultation with the aim of reducing the non-economic volatility in the variable annuity statutory balance sheet and enhancing risk management. The NAIC is targeting a January 2020 effective date for the new framework, which will have an impact on Jackson's business. Jackson continues to assess and test the changes. The NAIC also has an on-going review of the C-1 bond factors in the required capital calculation, on which further information is expected to be provided in due course. The Group's preparations to manage the impact of these reforms will continue.

In the EU, the European Commission began a review in late 2016 of some aspects of the Solvency II legislative package, which is expected to continue until 2021 and includes a review of the Long Term Guarantee measures.

On 27 July 2017, the UK FCA announced that it will no longer persuade, or use its powers to compel, panel banks to submit rates for the calculation of LIBOR after 2021. The discontinuation of LIBOR in its current form and its replacement with the Sterling Overnight Index Average benchmark (SONIA) in the UK (and other alternative benchmark rates in other countries) could, among other things, impact the Group through an adverse effect on the value of Prudential's assets and liabilities which are linked to, or which reference LIBOR, a reduction in market liquidity during any period of transition and increased legal and conduct risks to the Group arising from changes required to documentation and its related obligations to its stakeholders.

In Asia, regulatory regimes are developing at different speeds, driven by a combination of global factors and local considerations. New local capital rules and requirements could be introduced in these and other regulatory regimes that challenge legal or ownership structures, current sales practices, or could be applied to sales made prior to their introduction retrospectively, which could have a negative impact on Prudential's business or reported results.

Risk management and mitigation of regulatory and political risk at Prudential includes the following:
- Risk assessment of the Business Plan which includes consideration of current strategies;
- Close monitoring and assessment of our business environment and strategic risks;
- The consideration of risk themes in strategic decisions; and
- Ongoing engagement with national regulators, government policy teams and international standard setters.

b. ESG risks including climate change
The business environment in which Prudential operates is continually changing, and responding effectively to those material risks with ESG implications is crucial in maintaining Prudential's brand and reputation, and in turn its financial performance and its long-term strategy. The Group maintains active engagement with its key stakeholders, including investors, customers, employees, governments, policymakers and regulators in its key markets, as well as with international institutions – all of whom have expectations, which the Group must balance, as it responds to ESG-related matters.

Climate change is a key ESG theme which continues to move up the agenda of many regulators, governments, non-governmental organisations and investors. An overview of the various regulatory, supervisory and investor-driven initiatives related to climate change currently in progress; how the Group manages climate change risks and opportunities; and the Group's participation in industry initiatives in this area is outlined in the Corporate responsibility review. There has been increased regulatory and supervisory focus on sustainable finance and responsible investment. The Group recognises this and the ESG Executive Committee seeks, as one of its aims, to ensure a consistent approach in managing ESG considerations in its business activities, including investment activities.

The Group's operational risk framework explicitly incorporates ESG as a component of its social and environmental responsibility, brand management and external communications. This is further strengthened by factoring considerations for reputational impacts when the materiality of operational risks are assessed. Policies and procedures to support how the Group operates in relation to certain ESG issues are covered in the Group Governance Manual. Prudential manages key ESG issues though a multi-disciplinary approach with first line functional ownership for ESG topics. Further information on the Group's approach to governance on ESG issues and the relevant Group-wide policies for managing these are included in the Corporate responsibility review.

6.2 Risks from our investments

a. Market risk
The main drivers of market risk in the Group are:
- Investment risk, which arises on our holdings of equity and property investments, the prices of which can change depending on market conditions;

- Interest rate risk, which is driven by the valuation of Prudential's assets (particularly the bonds that it invests in) and liabilities, which are dependent on market interest rates and exposes it to the risk of those moving in a way that is detrimental; and
- Foreign exchange risk, through translation of its profits and assets and liabilities denominated in various currencies, given the geographical diversity of the business.

The main investment risk exposure arises from the portion of the profits from the UK and Hong Kong with-profits funds which the shareholders are entitled to receive; the value of the future fees from the fee-earning products in the Asia business; and from the asset returns backing Jackson's variable annuities business. Further detail is provided below.

The Group's interest rate risk is driven by the need to match the duration of its assets and liabilities in the UK and Europe insurance business and the fixed annuity business in Jackson. Interest rate risk also arises from the guarantees of some non unit-linked investment products in Asia; and the cost of guarantees in Jackson's fixed index and variable annuity business. Further detail is provided below.

The Group has appetite for market risk where it arises from profit-generating insurance activities to the extent that it remains part of a balanced portfolio of sources of income for shareholders and is compatible with a robust solvency position.

The Group's market risks are managed and mitigated by the following:
- Our market risk policy;
- Risk appetite statements, limits and triggers;
- Our asset and liability management programmes;
- Hedging derivatives, including equity options and futures, interest rate swaps and swaptions and currency forwards;
- The monitoring and oversight of market risks through the regular reporting of management information; and
- Regular deep dive assessments.

Equity and property investment risk
In the UK and Europe business, the main investment risk arises from the assets held in the with-profits funds through the shareholders' proportion of the funds' declared bonuses and policyholder net investment gains (future transfers). This investment risk is driven mainly by equities in the funds and some hedging to protect against a reduction in the value of these future transfers is performed outside the funds. The UK with-profits funds' Solvency II own funds, estimated at £9.7 billion as at 31 December 2018, helps to protect against market fluctuations and is protected partially against falls in equity markets through an active hedging programme within the fund.

In Asia, the shareholder exposure to equity price movements results from unit-linked products, where fee income is linked to the market value of the funds under management. Further exposure arises from with-profits businesses where bonuses declared are based broadly on historical and current rates of return from the Asia business' investment portfolios, which include equities.

In Jackson, investment risk arises from the assets backing customer policies. Equity risk is driven by the variable annuity business, where the assets are invested in both equities and bonds and the main risk to the shareholder comes from providing the guaranteed benefits offered. The exposure to this is primarily controlled by using a derivative hedging programme, as well as through the use of reinsurance to pass on the risk to third-party reinsurers.

While accepting the equity exposure that arises on future fees, the Group has limited appetite for exposures to equity price movements to remain unhedged or for volatility within policyholder guarantees after taking into account any natural offsets and buffers within the business.

Interest rate risk
Some products that Prudential offer are sensitive to movements in interest rates. As part of the Group's ongoing management of this risk, a number of mitigating actions to the in-force business have been taken, as well as repricing and restructuring new business offerings in response to recent relatively low interest rates. Nevertheless, some sensitivity to interest rate movements is still retained.

The Group's appetite for interest rate risk is limited to where assets and liabilities can be tightly matched and where liquid assets or derivatives exist to cover interest rate exposures.

In the UK and Europe insurance business, interest rate risk arises from the need to match the cash flows of its annuity obligations with those from its investments. The risk is managed by matching asset and liability durations as well as continually assessing the need for use of any derivatives. Under Solvency II rules, interest rate risk also results from the requirement to include a balance sheet risk margin. The with-profits business is also exposed to interest rate risk through some product guarantees. Such risk is largely borne by the with-profits fund itself although shareholder support may be required in extreme circumstances where the fund has insufficient resources to support the risk.

In Asia, our exposure to interest rate risk arises from the guarantees of some non-unit-linked investment products, including the Hong Kong with-profits business. This exposure exists because of the potential for asset and liability mismatch which, although it is small and managed appropriately, cannot be eliminated.

Jackson is affected by interest rate movements to its fixed annuity book where the assets are primarily invested in bonds and shareholder exposure comes from the mismatch between these assets and the guaranteed rates that are offered to policyholders. Interest rate risk results from the cost of guarantees in the variable annuity and fixed index annuity business, which may increase when interest rates fall. The level of sales of variable annuity products with guaranteed living benefits is actively monitored, and the risk limits we have in place help to ensure comfort with the level of interest rate and market risks incurred as a result. Derivatives are also used to provide some protection.

Foreign exchange risk

The geographical diversity of Prudential's businesses means that it has some exposure to the risk of foreign exchange rate fluctuations. The operations in the US and Asia, which represent a large proportion of operating profit and shareholders' funds, generally write policies and invest in assets in local currencies. Although this limits the effect of exchange rate movements on local operating results, it can lead to fluctuations in the Group financial statements when results are reported in UK sterling. This risk is accepted within our appetite for foreign exchange risk.

In cases where a surplus arises in an overseas operation which is to be used to support Group capital, or where a significant cash payment is due from an overseas subsidiary to the Group, this currency exposure may be hedged where it is believed to be favourable economically to do so. Further, the Group generally does not have appetite for significant direct shareholder exposure to foreign exchange risks in currencies outside the countries in which it operates, but it does have some appetite for this on fee income and on non-sterling investments within the with-profits fund. Where foreign exchange risk arises outside appetite, currency swaps and other derivatives are used to manage the exposure.

b. Credit risk

Prudential invests in bonds that provide a regular, fixed amount of interest income (fixed income assets) in order to match the payments needed to policyholders. It also enters into reinsurance and derivative contracts with third parties to mitigate various types of risk, as well as holding cash deposits at certain banks. As a result, it is exposed to credit risk and counterparty risk across its business.

Credit risk is the potential for reduction in the value of investments which results from the perceived level of risk of an investment issuer being unable to meet its obligations (defaulting). Counterparty risk is a type of credit risk and relates to the risk that the counterparty to any contract we enter into being unable to meet their obligations causing us to suffer loss.

The Group has some appetite to take credit risk where it arises from profit-generating insurance activities, to the extent that it remains part of a balanced portfolio of sources of income for shareholders and is compatible with a robust solvency position.

A number of risk management tools are used to manage and mitigate this credit risk, including the following:

- A credit risk policy and dealing and controls policy;
- Risk appetite statements and limits that have been defined on issuers, and counterparties;
- Collateral arrangements for derivative, secured lending reverse repurchase and reinsurance transactions;
- The Group Credit Risk Committee's oversight of credit and counterparty credit risk and sector and/or name-specific reviews;
- Regular assessments; and
- Close monitoring or restrictions on investments that may be of concern.

Debt and loan portfolio

Prudential's UK and Europe business is exposed to credit risk on fixed income assets in the shareholder-backed portfolio. At 31 December 2018, this portfolio contained fixed income assets worth £21.6 billion. M&GPrudential's debt portfolio reduced by £12.1 billion following the transfer of fixed income assets to Rothesay Life as part of the reinsurance agreement announced in March 2018. Credit risk arising from a further £64.3 billion of fixed income assets is borne largely by the with-profits fund, to which the shareholder is not exposed directly although under extreme circumstances shareholder support may be required if the fund is unable to meet payments as they fall due.

Credit risk also arises from the debt portfolio in the Asia business, the value of which was £45.8 billion at 31 December 2018. The majority (68 per cent) of the portfolio is in unit-linked and with-profits funds and so exposure of the shareholder to this component is minimal. The remaining 32 per cent of the debt portfolio is held to back the shareholder business.

In the general account of the Jackson business £41.6 billion of fixed income assets are held to support shareholder liabilities including those from our fixed annuities, fixed index annuities and life insurance products. Jackson's general account portfolio increased by circa £4 billion due to the John Hancock acquisition.

The shareholder-owned debt and loan portfolio of the Group's other operations was £2.0 billion as at 31 December 2018.

Further details of the composition and quality of our debt portfolio, and exposure to loans, can be found in the IFRS financial statements.

Group sovereign debt

Prudential also invests in bonds issued by national governments. This sovereign debt represented 18 per cent or £14.4 billion of the shareholder debt portfolio as at 31 December 2018 (31 December 2017: 19 per cent or £16.5 billion). 3 per cent of this was rated AAA and 87 per cent was considered investment grade (31 December 2017: 90 per cent investment grade).

The particular risks associated with holding sovereign debt are detailed further in our disclosures on risk factors.

The exposures held by the shareholder-backed business and with-profits funds in sovereign debt securities at 31 December 2018 are given in note C3.2(f) of the Group's IFRS financial statements.

Bank debt exposure and counterparty credit risk

Prudential's exposure to banks is a key part of its core investment business, as well as being important for the hedging and other activities undertaken to manage its various financial risks. Given the importance of its relationship with its banks, exposure to the sector is considered a material risk for the Group.

The exposures held by the shareholder-backed business and with-profits funds in bank debt securities at 31 December 2018 are given in note C3.2(f) of the Group's IFRS financial statements.

The exposure to derivative counterparty and reinsurance counterparty credit risk is managed using an array of risk management tools, including a comprehensive system of limits. Where appropriate, Prudential reduces its exposure, buys credit protection or uses additional collateral arrangements to manage its levels of counterparty credit risk.

At 31 December 2018, shareholder exposures by rating[1] and sector[2] are shown below:

- 95 per cent of the shareholder portfolio is investment grade rated. In particular, 66 per cent of the portfolio is rated A- and above (or equivalent); and
- The Group's shareholder portfolio is well diversified: no individual sector makes up more than 15 per cent of the total portfolio (excluding the financial and sovereign sectors).

c. Liquidity risk

Prudential's liquidity risk arises from the need to have sufficient liquid assets to meet policyholder and third-party payments as they fall due. This incorporates the risk arising from funds composed of illiquid assets and results from a mismatch between the liquidity profile of assets and liabilities. Liquidity risk may impact on market conditions and valuation of assets in a more uncertain way than for other risks like interest rate or credit risk. It may arise, for example, where external capital is unavailable at sustainable cost, increased liquid assets are required to be held as collateral under derivative transactions or where redemption requests are made against Prudential external funds.

Prudential has no appetite for liquidity risk, ie for any business to have insufficient resources to cover its outgoing cash flows, or for the Group as a whole to not meet cash flow requirements from its debt obligations under any plausible scenario.

The Group has significant internal sources of liquidity, which are sufficient to meet all of our expected cash requirements for at least 12 months from the date the financial statements are approved, without having to resort to external sources of funding. The Group has a total of £2.6 billion of undrawn committed facilities that can be made use of, expiring in 2023. Access to further liquidity is available through the debt capital markets and an extensive commercial paper programme in place, and Prudential has maintained a consistent presence as an issuer in the market for the past decade.

A number of risk management tools are used to manage and mitigate this liquidity risk, including the following:

- The Group's liquidity risk policy;
- Risk appetite statements, limits and triggers;
- Regular assessment at Group and business units of LCRs which are calculated under both base case and stressed scenarios and are reported to committees and the Board;
- The Group's Liquidity Risk Management Plan, which includes details of the Group Liquidity Risk Framework as well as gap analysis of liquidity risks and the adequacy of available liquidity resources under normal and stressed conditions;
- Regular stress testing;
- Our contingency plans and identified sources of liquidity;
- The Group's ability to access the money and debt capital markets;
- Regular deep dive assessments; and
- The Group's access to external committed credit facilities.

6.3 Risks from our products

a. Insurance risk

Insurance risk makes up a significant proportion of Prudential's overall risk exposure. The profitability of its businesses depends on a mix of factors, including levels of, and trends in, mortality (policyholders dying), morbidity (policyholders becoming ill) and policyholder behaviour (variability in how customers interact with their policies, including utilisation of withdrawals, take-up of options and guarantees and persistency, ie lapsing of policies), and increases in the costs of claims, including the level of medical expenses increases over and above price inflation (claim inflation).

The Group has appetite for retaining insurance risks in order to create shareholder value in the areas where it believes it has expertise and controls to manage the risk and can support such risk with its capital and solvency position.

The principal drivers of the Group's insurance risk vary across its business units. At M&GPrudential, this is predominantly longevity risk. Across Asia, where a significant volume of health protection business is written, the most significant insurance risks are morbidity risk, persistency risk, and medical inflation risk. In Jackson, policyholder behaviour risk is particularly material, especially in the take up of options and guarantees on variable annuity business.

The Group manages longevity risk in various ways. Longevity reinsurance is a key tool in managing this risk. In March 2018, the Group's longevity risk exposure was significantly reduced by reinsuring £12 billion in UK annuity liabilities to Rothesay Life, pursuant to a Part VII transfer of the majority of these liabilities expected to be completed by 30 June 2019. Although Prudential has withdrawn from selling new UK annuity business, given its significant annuity portfolio the assumptions it makes about future rates of improvement in mortality rates remain key to the measurement of its insurance liabilities and to its assessment of any reinsurance transactions. Prudential continues to conduct research into longevity risk using both experience from its annuity portfolio and industry data. Although the general consensus in recent years is that people are living longer, the rate of increase has slowed in recent years, and there is considerable volatility in year-on-year longevity experience, which is why it needs expert judgement in setting its longevity basis.

Prudential's morbidity risk is mitigated by appropriate underwriting when policies are issued and claims are received. Our morbidity assumptions reflect our recent experience and expectation of future trends for each relevant line of business.

In Asia, Prudential writes significant volumes of health protection business, and so a key assumption is the rate of medical inflation, which is often in excess of general price inflation. There is a risk that the expenses of medical treatment increase more than expected, so the medical claim cost passed on to Prudential is higher than anticipated. Medical expense inflation risk is best mitigated by retaining the right to reprice our products each year and by having suitable overall claim limits within its policies, either limits per type of claim or in total across a policy.

The Group's persistency assumptions reflect similarly a combination of recent past experience for each relevant line of business and expert judgement, especially where a lack of relevant and credible experience data exists. Any expected change in future persistency is also reflected in the assumption. Persistency risk is managed by appropriate training and sales processes and managed locally post-sale through regular experience monitoring and the identification of common characteristics of business with high lapse rates. Where appropriate, allowance is made for the relationship (either assumed or observed historically) between persistency and investment returns and any additional risk is accounted for. Modelling this dynamic policyholder behaviour is particularly important when assessing the likely take-up rate of options embedded within certain products. The effect of persistency on the Group's financial results can vary but depends mostly on the value of the product features and market conditions.

Prudential's insurance risks are managed and mitigated using the following:
- The Group's insurance and underwriting risk policies;
- The risk appetite statements, limits and triggers;
- Using longevity, morbidity and persistency assumptions that reflect recent experience and expectation of future trends, and industry data and expert judgement where appropriate;
- Using reinsurance to mitigate longevity and morbidity risks;
- Ensuring appropriate medical underwriting when policies are issued and appropriate claims management practices when claims are received in order to mitigate morbidity risk;
- Maintaining the quality of sales processes and using initiatives to increase customer retention in order to mitigate persistency risk;
- Using product repricing and other claims management initiatives in order to mitigate medical expense inflation risk; and
- Regular deep dive assessments.

6.4 Risks from our business operations

a. Strategic and transformation risks
A number of significant change programmes are currently running in order to implement the Group's strategy and the need to comply with emerging regulatory changes. These include, but are not limited to, the discontinuation of LIBOR and implementation of new international accounting standards – see section 6.1a. above for further information. This has resulted in a significant portfolio of change initiatives which increases the transformation risks for the Group, and is likely to further increase in the future. In particular the demerger of M&GPrudential from the rest of the Group has resulted in a substantial transformation programme which needs to be delivered alongside, and in conjunction with other material change programmes. The scale and the complexity of this portfolio of transformation programmes could impact business operations, weaken the control environment, impact customers, and has the potential for reputational damage if these programmes fail to deliver their objectives. Implementing further strategic initiatives may amplify these risks.

Other significant change initiatives are occurring across the Group that increase the likelihood and potential impact of risks associated with:
- Complex dependencies between multiple programmes spanning different businesses;
- The organisational ability to absorb change being exceeded while maintaining a stable and robust control environment ;
- Unrealised business objectives/benefits; and
- Failures in programme and/or project design, execution or transition into business as usual.

b. Non-financial risks
In the course of doing business, the Group is exposed to non-financial risks arising from its operations, the business environment and its strategy. The main risks across these areas are detailed below.

<u>Operational risks</u>
Prudential defines operational risk as the risk of loss (or unintended gain or profit) arising from inadequate or failed internal processes, personnel or systems, or from external events. This includes employee error, model error, system failures, fraud or some other event which disrupts business processes or has a detrimental impact to customers. Processes are established for activities across the scope of our business, including operational activity, regulatory compliance, and those supporting environmental, social and governance (ESG) activities more broadly, any of which can expose us to operational risks. A large volume of complex transactions are processed by the Group across a number of diverse products, and are subject to a high number of varying legal, regulatory and tax regimes. Prudential has no appetite for material losses (direct or indirect) suffered as a result of failing to develop, implement or monitor appropriate controls to manage operational risks.

The Group's outsourcing and third-party relationships require distinct oversight and risk management processes. A number of important third-party relationships exist which provide the distribution and processing of Prudential's products, both as market counterparties and as outsourcing partners. M&GPrudential outsources several operations, including a significant part of its back office, customer-facing functions and a number of IT functions. In Asia, the Group continues to expand its strategic partnerships and renew bancassurance arrangements. These third-party arrangements support Prudential in providing a high level and cost-effective service to our customers, but they also make us reliant on the operational performance of our outsourcing partners.

The Group's requirements for the management of material outsourcing arrangements, which are in accordance with relevant applicable regulations, are included through its well-established Group-wide third-party supply policy. Third-party management is also included in embedded in the Group-wide framework and risk management for operational risk (see further, below). Third-party management forms part of the Group's Operational Risk categorisations and a defined qualitative risk appetite statement, limits and triggers are in place.

The performance of the Group's core business activities places reliance on the IT infrastructure that supports day-to-day transaction processing and administration. The IT environment must also be secure and an increasing cyber risk threat needs to be addressed as the Group's digital footprint increases and the sophistication of cyber threats continue to evolve – see separate information security risk sub-section below. The risk that Prudential's IT infrastructure does not meet these requirements is a key area of focus for the Group, particularly the risk that legacy infrastructure supporting core activities/processes affects business continuity or impacts on business growth.

Operational challenges also exist in keeping pace with regulatory changes This requires implementing processes to ensure we are, and remain, compliant on an ongoing basis, including regular monitoring and reporting. The high rate of global regulatory change, in an already complex regulatory landscape, increases the risk of non-compliance due to a failure to identify, interpret correctly, implement and/or monitor regulatory compliance. The change in Group-wide supervisor, and the supervisory framework, to which Prudential plc will be subject to after the demerger of M&GPrudential, means that additional processes, or changes to existing ones, may be required to ensure ongoing compliance. See the 'Global regulatory and political risk' section above. Legislative developments over recent years, together with enhanced regulatory oversight and increased capability to issue sanctions, have resulted in a complex regulatory environment that may lead to breaches of varying magnitude if the Group's business-as-usual operations are not compliant. As well as prudential regulation, the Group focuses on conduct regulation, including those related to sales practice and anti-money laundering, bribery and corruption. There is a particular focus on regulations related to the latter in newer/emerging markets.

Group-wide framework and risk management for operational risk

The risks detailed above form key elements of the Group's operational risk profile. In order to identify, assess, manage, control and report effectively on all operational risks across the business, a Group-wide operational risk framework is in place. The key components of the framework are:

- Application of a risk and control assessment (RCA) process, where operational risk exposures are identified and assessed as part of a periodical cycle. The RCA process considers a range of internal and external factors, including an assessment of the control environment, to determine the business's most significant risk exposures on a prospective basis;
- An internal incident management process, which identifies, quantifies and monitors remediation conducted through root cause analysis and application of action plans for risk events that have occurred across the business;
- A scenario analysis process for the quantification of extreme, yet plausible manifestations of key operational risks across the business on a forward-looking basis. This is carried out at least annually and supports external and internal capital requirements as well as informing risk oversight activity across the business; and
- An operational risk appetite framework that articulates the level of operational risk exposure the business is willing to tolerate, covering all operational risk categories, and sets out escalation processes for breaches of appetite.

Outputs from these processes and activities performed by individual business units are monitored by the Group Risk function, which provides an aggregated view of the risk profile across the business to the Group Risk Committee and Board.

These core framework components are embedded across the Group via the Group Operational Risk Policy and Standards documents, which set out the key principles and minimum standards for the management of operational risk across the Group.

The Group Operational Risk Policy, standards and operational risk appetite framework sit alongside other risk policies and standards that individually engage with key operational risks, including outsourcing and third-party supply, business continuity, technology and data, operations processes and extent of transformation.

These policies and standards include subject matter expert-led processes that are designed to identify, assess, manage and control operational risks, including the application of:

- A transformation risk framework that assesses, manages and reports on the end-to-end transformation lifecycle, project prioritisation and the risks, interdependencies and possible conflicts arising from a large portfolio of transformation activities;
- Internal and external review of cyber security capability and defences;
- Regular updating and testing of elements of disaster-recovery plans and the Critical Incident Procedure process;
- Group and business unit-level compliance oversight and testing in respect of adherence with in-force regulations;
- Regulatory change teams in place to assist the business in proactively adapting and complying with regulatory developments;
- A framework in place for emerging risk identification and analysis in order to capture, monitor and allow us to prepare for operational risks that may crystallise beyond the short-term horizon;
- Corporate insurance programmes to limit the financial impact of operational risks; and
- Reviews of key operational risks and challenges within Group and business unit business plans.

These activities are fundamental in maintaining an effective system of internal control, and as such outputs from these also inform core RCA, incident management and scenario analysis processes and reporting on operational risk. Furthermore, they also ensure that operational risk considerations are embedded in key business decision-making, including material business approvals and in setting and challenging the Group's strategy.

Business resilience

Business resilience is at the core of the Group's well embedded Business Continuity Management (BCM) programme, with BCM being one of a number of activities undertaken by the Group Security function that protect our key stakeholders.

Prudential operates a BCM programme and framework that is linked with its business activities, which considers key areas including business impact analyses, risk assessments, incident management plans, disaster recovery plans, and the exercising and execution of these plans. The programme is designed to achieve a business continuity capability that meets evolving business needs and is appropriate to the size, complexity and nature of the Group's operations, with ongoing proactive maintenance and improvements to resilience against the disruption of the Group's ability to meet its key objectives and protect its brand and reputation. The BCM programme is supported by Group-wide governance policies and procedures and is based on industry standards that meet legal and regulatory obligations.

Business disruption risks are monitored by the Group Security function, with reporting of key operational effectiveness metrics and updates on specific activities being reported to the Group Risk Committee where required and discussed by cross-functional working groups.

Information security risk and data privacy

Information security risk remains an area of heightened focus after a number of recent high-profile attacks and data losses across industries. Criminal capability in this area is maturing and industrialising, with an increased level of understanding of complex financial transactions which increases the risks to the financial services industry. The threat landscape is continuously evolving, and the systemic risk of sophisticated but untargeted attacks is rising, particularly during times of heightened geopolitical tensions.

Recent developments in data protection worldwide (such as GDPR that came into force in May 2018) increases the financial and reputational implications for Prudential of a breach of its (or third-party suppliers') IT systems. As well as data protection, increasingly stakeholder expectations are that companies and organisations use personal information transparently and appropriately. Given this, both information security and data privacy are key risks for the Group. As well as preventative risk management, it is fundamental that robust critical recovery systems are in place in the event of a successful attack on the Group's infrastructure, breach of information security or failure of its systems to retain its customer relationships and trusted reputation.

In 2018, the organisational structure and governance model for cyber security management was revised with the appointment of a Group Chief Information Security Officer, and a repositioning of the function to allow increased focus on execution. This organisational change will increase the Group's efficiency and agility in responding to cyber security-related incidents, and will facilitate increased collaboration between business units and leverages their respective strengths in delivering the Group-wide Information Security Programme.

The objectives of the programme include achieving consistency in the execution of security disciplines across the Group and improving visibility across the Group's businesses; deployment of automation to detect and address threats; and achieving security by design by aligning subject matter expertise to the Group's digital and business initiatives to embed security controls across platforms and ecosystems.

The Board receives periodic updates on information security risk management throughout the year. Group functions work with the business units to address risks locally within the national and regional context of each business following the strategic direction of the Group-wide information security function.

Notes
1 Based on hierarchy of Standard and Poor's, Moody's and Fitch, where available and if unavailable, other rating agencies or internal ratings have been used.
2 Source of segmentation: Bloomberg Sector, Bloomberg Group and Merrill Lynch. Anything that cannot be identified from the three sources noted is classified as other. Excludes debt securities from other operations.

Corporate governance

The Board confirms that it has complied with all the principles and provisions set out in the Hong Kong Code on Corporate Governance Practices (the HK Code) throughout the accounting period with the following exception. With respect to Code Provision B.1.2(d) of the HK Code, the responsibilities of the Remuneration Committee do not include making recommendations to the Board on the remuneration of non-executive directors. In line with the principles of the UK Code, fees for Non-executive Directors are determined by the Board.

The directors also confirm that the financial results contained in this document have been reviewed by the Group Audit Committee.

The company confirms that it has adopted a code of conduct regarding securities transactions by directors on terms no less exacting than required by the Hong Kong Listing Rules and that the directors of the Company have complied with this code of conduct throughout the year.

IFRS Disclosure and Additional Unaudited Financial Information
Prudential plc 2018 results
International Financial Reporting Standards (IFRS) basis results

International Financial Reporting Standards (IFRS) Basis Results

Consolidated income statement

	Note	2018 £m	2017 £m
Gross premiums earned		**47,224**	44,005
Outward reinsurance premiums[note (i)]		**(14,023)**	(2,062)
Earned premiums, net of reinsurance		**33,201**	41,943
Investment return		**(10,263)**	42,189
Other income[note (ii)]		**1,993**	2,258
Total revenue, net of reinsurance		**24,931**	86,390
Benefits and claims[note (i)]		**(27,411)**	(71,854)
Outward reinsurers' share of benefit and claims[note (i)]		**13,554**	2,193
Movement in unallocated surplus of with-profits funds		**1,289**	(2,871)
Benefits and claims and movement in unallocated surplus of with-profits funds, net of reinsurance		**(12,568)**	(72,532)
Acquisition costs and other expenditure[note (ii)]	B2	**(8,855)**	(9,993)
Finance costs: interest on core structural borrowings of shareholder-financed businesses		**(410)**	(425)
(Loss) gain on disposal of businesses and corporate transactions	D1.1	**(80)**	223
Remeasurement of the sold Korea life business		**–**	5
Total charges, net of reinsurance and (loss) gain on disposal of businesses		**(21,913)**	(82,722)
Share of profits from joint ventures and associates, net of related tax		**291**	302
Profit before tax *(being tax attributable to shareholders' and policyholders' returns)*[note (iii)]		**3,309**	3,970
Less tax credit (charge) attributable to policyholders' returns		**326**	(674)
Profit before tax attributable to shareholders	B1.1	**3,635**	3,296
Total tax charge attributable to policyholders and shareholders	B4	**(296)**	(1,580)
Adjustment to remove tax (credit) charge attributable to policyholders' returns		**(326)**	674
Tax charge attributable to shareholders' returns	B4	**(622)**	(906)
Profit for the year		**3,013**	2,390
Attributable to:			
Equity holders of the Company		**3,010**	2,389
Non-controlling interests		**3**	1
Profit for the year		**3,013**	2,390

Earnings per share (in pence)	Note	2018	2017
Based on profit attributable to the equity holders of the Company:	B5		
Basic		**116.9p**	93.1p
Diluted		**116.8p**	93.0p

Dividends per share (in pence)	Note	2018	2017
Dividends relating to reporting year:	B6		
First interim ordinary dividend		**15.67p**	14.50p
Second interim ordinary dividend		**32.50p**	32.50p
Total		**48.17p**	47.00p
Dividends paid in reporting year:	B6		
Current year first interim dividend		**15.67p**	14.50p
Second interim ordinary dividend for prior year		**32.50p**	30.57p
Total		**48.17p**	45.07p

Notes

(i) Outward reinsurance premiums include the £(12,149) million paid during the year in respect of the reinsurance of the UK annuity portfolio. The associated increase in reinsurance assets is included in outward reinsurers' share of benefits and claims and the consequential change to policyholder liabilities is included in benefits and claims. See note D1.1 for further details.

(ii) The 2017 comparative results have been re-presented from those previously published for the deduction of certain expenses against revenue following the adoption of IFRS 15. See note A2.

(iii) This measure is the formal profit before tax measure under IFRS but it is not the result attributable to shareholders. This is principally because the corporate taxes of the Group include those on the income of consolidated with-profits and unit-linked funds that, through adjustments to benefits, are borne by policyholders. These amounts are required to be included in the tax charge of the Company under IAS 12. Consequently, the profit before all taxes measure is not representative of pre-tax profits attributable to shareholders. Profit before all taxes is determined after deducting the cost of policyholder benefits and movements in the liability for unallocated surplus of with-profits funds after adjusting for taxes borne by policyholders.

International Financial Reporting Standards (IFRS) Basis Results

Consolidated statement of comprehensive income

	Note	2018 £m	2017 £m
Profit for the year		**3,013**	2,390
Other comprehensive income (loss):			
Items that may be reclassified subsequently to profit or loss			
Exchange movements on foreign operations and net investment hedges:			
Exchange movements arising during the year	A1	**344**	(404)
Cumulative exchange gain of sold Korea life business recycled through profit or loss		**–**	(61)
Related tax		**5**	(5)
		349	(470)
Net unrealised valuation movements on securities of US insurance operations classified as available-for-sale:			
Net unrealised holding (losses) gains arising in the year		**(1,606)**	591
(Deduct net gains) add back net losses included in the income statement on disposal and impairment		**(11)**	26
Total	C3.2(c)	**(1,617)**	617
Related change in amortisation of deferred acquisition costs	C5.2	**246**	(76)
Related tax	C8.1	**288**	(55)
		(1,083)	486
Total		**(734)**	16
Items that will not be reclassified to profit or loss			
Shareholders' share of actuarial gains and losses on defined benefit pension schemes:			
Actuarial gains and losses on defined benefit pension schemes		**134**	200
Related tax		**(23)**	(33)
		111	167
Deduct amount attributable to UK with-profit funds transferred to unallocated surplus of with-profit funds, net of related tax		**(38)**	(78)
		73	89
Other comprehensive (loss) income for the year, net of related tax		**(661)**	105
Total comprehensive income for the year		**2,352**	2,495
Attributable to:			
Equity holders of the Company		**2,348**	2,494
Non-controlling interests		**4**	1
Total comprehensive income for the year		**2,352**	2,495

International Financial Reporting Standards (IFRS) Basis Results

Consolidated statement of changes in equity

		Year ended 31 December 2018 £m							
	Note	Share capital C10	Share premium C10	Retained earnings	Translation reserve	Available -for-sale securities reserves	Shareholders' equity	Non-controlling interests	Total equity
Reserves									
Profit for the year		**–**	**–**	**3,010**	**–**	**–**	**3,010**	**3**	**3,013**
Other comprehensive income:									
Exchange movements on foreign operations and net investment hedges, net of related tax		**–**	**–**	**–**	**348**	**–**	**348**	**1**	**349**
Net unrealised valuation movements, net of related change in amortisation of deferred acquisition costs and related tax		**–**	**–**	**–**	**–**	**(1,083)**	**(1,083)**	**–**	**(1,083)**
Shareholders' share of actuarial gains and losses on defined benefit pension schemes, net of related tax		**–**	**–**	**73**	**–**	**–**	**73**	**–**	**73**
Total other comprehensive income (loss)		**–**	**–**	**73**	**348**	**(1,083)**	**(662)**	**1**	**(661)**
Total comprehensive income for the year		**–**	**–**	**3,083**	**348**	**(1,083)**	**2,348**	**4**	**2,352**
Dividends	B6	**–**	**–**	**(1,244)**	**–**	**–**	**(1,244)**	**–**	**(1,244)**
Reserve movements in respect of share-based payments		**–**	**–**	**69**	**–**	**–**	**69**	**–**	**69**
Change in non-controlling interests	D1.2	**–**	**–**	**–**	**–**	**–**	**–**	**7**	**7**
Movements in respect of option to acquire non-controlling interests	D1.2	**–**	**–**	**(109)**	**–**	**–**	**(109)**	**–**	**(109)**
Share capital and share premium									
New share capital subscribed	C10	**1**	**16**	**–**	**–**	**–**	**17**	**–**	**17**
Treasury shares									
Movement in own shares in respect of share-based payment plans		**–**	**–**	**29**	**–**	**–**	**29**	**–**	**29**
Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS		**–**	**–**	**52**	**–**	**–**	**52**	**–**	**52**
Net increase (decrease) in equity		**1**	**16**	**1,880**	**348**	**(1,083)**	**1,162**	**11**	**1,173**
At beginning of year		**129**	**1,948**	**12,326**	**840**	**844**	**16,087**	**7**	**16,094**
At end of year		**130**	**1,964**	**14,206**	**1,188**	**(239)**	**17,249**	**18**	**17,267**

International Financial Reporting Standards (IFRS) Basis Results

Consolidated statement of changes in equity

		Year ended 31 December 2017 £m							
	Note	**Share capital** C10	**Share premium** C10	**Retained earnings**	**Translation reserve**	**Available -for-sale securities reserves**	**Shareholders' equity**	**Non-controlling interests**	**Total equity**
Reserves									
Profit for the year		–	–	2,389	–	–	2,389	1	2,390
Other comprehensive income:									
Exchange movements on foreign operations and net investment hedges, net of related tax		–	–	–	(470)	–	(470)	–	(470)
Net unrealised valuation movements, net of related change in amortisation of deferred acquisition costs and related tax		–	–	–	–	486	486	–	486
Shareholders' share of actuarial gains and losses on defined benefit pension schemes, net of related tax		–	–	89	–	–	89	–	89
Total other comprehensive income (loss)		–	–	89	(470)	486	105	–	105
Total comprehensive income for the year		–	–	2,478	(470)	486	2,494	1	2,495
Dividends	B6	–	–	(1,159)	–	–	(1,159)	–	(1,159)
Reserve movements in respect of share-based payments		–	–	89	–	–	89	–	89
Change in non-controlling interests		–	–	–	–	–	–	5	5
Share capital and share premium									
New share capital subscribed	C10	–	21	–	–	–	21	–	21
Treasury shares									
Movement in own shares in respect of share-based payment plans		–	–	(15)	–	–	(15)	–	(15)
Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS		–	–	(9)	–	–	(9)	–	(9)
Net increase (decrease) in equity		–	21	1,384	(470)	486	1,421	6	1,427
At beginning of year		129	1,927	10,942	1,310	358	14,666	1	14,667
At end of year		129	1,948	12,326	840	844	16,087	7	16,094

International Financial Reporting Standards (IFRS) Basis Results

Consolidated statement of financial position

	Note	31 Dec 2018 £m	31 Dec 2017 £m
Assets			
Goodwill	C5.1	**1,857**	1,482
Deferred acquisition costs and other intangible assets	C5.2	**11,923**	11,011
Property, plant and equipment		**1,409**	789
Reinsurers' share of insurance contract liabilities		**11,144**	9,673
Deferred tax assets	C8	**2,595**	2,627
Current tax recoverable		**618**	613
Accrued investment income		**2,749**	2,676
Other debtors		**4,088**	2,963
Investment properties		**17,925**	16,497
Investment in joint ventures and associates accounted for using the equity method		**1,733**	1,416
Loans	C3.3	**18,010**	17,042
Equity securities and portfolio holdings in unit trusts[note (i)]		**214,733**	223,391
Debt securities[note (i)]	C3.2	**175,356**	171,374
Derivative assets		**3,494**	4,801
Other investments[note (i)]		**6,512**	5,622
Deposits		**11,796**	11,236
Assets held for sale[note (ii)]		**10,578**	38
Cash and cash equivalents	C1	**12,125**	10,690
Total assets	C1	**508,645**	493,941
Equity			
Shareholders' equity		**17,249**	16,087
Non-controlling interests		**18**	7
Total equity		**17,267**	16,094
Liabilities			
Insurance contract liabilities	C4.1	**322,666**	328,172
Investment contract liabilities with discretionary participation features	C4.1	**67,413**	62,677
Investment contract liabilities without discretionary participation features	C4.1	**19,222**	20,394
Unallocated surplus of with-profits funds	C4.1	**15,845**	16,951
Core structural borrowings of shareholder-financed businesses	C6.1	**7,664**	6,280
Operational borrowings attributable to shareholder-financed businesses	C6.2	**998**	1,791
Borrowings attributable to with-profits businesses	C6.2	**3,940**	3,716
Obligations under funding, securities lending and sale and repurchase agreements		**6,989**	5,662
Net asset value attributable to unit holders of consolidated unit trusts and similar funds		**11,651**	8,889
Deferred tax liabilities	C8	**4,022**	4,715
Current tax liabilities		**568**	537
Accruals, deferred income and other liabilities	C1	**15,248**	14,185
Provisions		**1,078**	1,123
Derivative liabilities		**3,506**	2,755
Liabilities held for sale[note (ii)]		**10,568**	–
Total liabilities	C1	**491,378**	477,847
Total equity and liabilities		**508,645**	493,941

Notes

(i) Included within equity securities and portfolio holdings in unit trusts, debt securities and other investments are £8,278 million (31 December 2017: £8,232 million) of lent securities and assets subject to repurchase agreements.

(ii) Assets held for sale of £10,578 million include £10,568 million in respect of the reinsured UK annuity business. A corresponding amount is reflected in liabilities held for sale. See note D1.1 for further details.

International Financial Reporting Standards (IFRS) Basis Results

Consolidated statement of cash flows

	Note	2018 £m	2017 £m
Cash flows from operating activities			
Profit before tax *(being tax attributable to shareholders' and policyholders' returns)*note (i)		**3,309**	3,970
Adjustments to profit before tax for non-cash movements in operating assets and liabilities:			
Investments		**15,456**	(49,771)
Other non-investment and non-cash assets		**(3,503)**	(968)
Policyholder liabilities (including unallocated surplus)		**(17,392)**	44,877
Other liabilities (including operational borrowings)		**4,344**	3,360
Interest income and expense and dividend income included in result before tax		**(7,861)**	(8,994)
Operating cash items:			
Interest receipts and payments		**5,793**	6,900
Dividend receipts		**2,361**	2,612
Tax paidnote (iv)		**(625)**	(915)
Other non-cash items		**582**	549
Net cash flows from operating activities		**2,464**	1,620
Cash flows from investing activities			
Purchases of property, plant and equipment		**(289)**	(134)
Proceeds from disposal of property, plant and equipment		**4**	–
Acquisition of businesses and intangiblesnote (v)		**(504)**	(351)
Sale of businessesnote (v)		**–**	1,301
Net cash flows from investing activities		**(789)**	816
Cash flows from financing activities			
Structural borrowings of the Group:			
Shareholder-financed businesses:note (ii)	C6.1		
Issue of subordinated debt, net of costs		**1,630**	565
Redemption of subordinated debt		**(434)**	(751)
Fees paid to modify terms and conditions of senior debtnote (ii)		**(33)**	–
Interest paid		**(376)**	(369)
With-profits businesses:note (iii)	C6.2		
Redemption of subordinated debt		**(100)**	–
Interest paid		**(4)**	(9)
Equity capital:			
Issues of ordinary share capital		**17**	21
Dividends paid		**(1,244)**	(1,159)
Net cash flows from financing activities		**(544)**	(1,702)
Net increase in cash and cash equivalents		**1,131**	734
Cash and cash equivalents at beginning of year		**10,690**	10,065
Effect of exchange rate changes on cash and cash equivalents		**304**	(109)
Cash and cash equivalents at end of year		**12,125**	10,690

Notes

(i) This measure is the formal profit before tax measure under IFRS but it is not the result attributable to shareholders.

(ii) Structural borrowings of shareholder-financed businesses exclude borrowings to support short-term fixed income securities programmes, non-recourse borrowings of investment subsidiaries of shareholder-financed businesses and other borrowings of shareholder-financed businesses. Cash flows in respect of these borrowings are included within cash flows from operating activities. The changes in the carrying value of the structural borrowings of shareholder-financed businesses during 2018 are analysed as follows:

	Cash movements £m				Non-cash movements £m		
	Balance at beginning of year	Issue of debt	Redemption of debt	Modification of debt*	Foreign exchange movement	Other movements	Balance at end of year
2018	**6,280**	**1,630**	**(434)**	**(33)**	**210**	**11**	**7,664**
2017	6,798	565	(751)	–	(341)	9	6,280

* The amount in 2018 relates to fees paid to bondholders who participated in the voting process in respect of certain modifications to the terms and conditions of the senior debt. Other than these fees, the modification did not result in an adjustment to the carrying value of the senior debt.

(iii) Interest paid on structural borrowings of with-profits businesses relates solely to the £100 million 8.5 per cent undated subordinated guaranteed bonds, which contribute to the solvency base of the Scottish Amicable Insurance Fund (SAIF), a ring-fenced sub-fund of the UK with-profits fund. These bonds were redeemed in full on 30 June 2018. Cash flows in respect of other borrowings of with-profits funds, which principally relate to consolidated investment funds, are included within cash flows from operating activities.

(iv) Tax paid includes £134 million (2017: £298 million) paid on profits taxable at policyholder rather than shareholder rates.

(v) Cash flows arising from the 'acquisition of businesses and intangibles' and 'sale of businesses' include amounts paid for distribution rights and cash flows arising from the acquisitions and disposals of businesses (including subsidiaries acquired and disposed by with-profits funds for investment purposes).

Notes

A Background

A1 Basis of preparation and exchange rates

These statements have been prepared in accordance with IFRS Standards as issued by the International Accounting Standards Board (IASB) and as endorsed by the European Union (EU) as required by EU law (IAS Regulation EC1606/2032). EU-endorsed IFRS Standards may differ from IFRS Standards issued by the IASB if, at any point in time, new or amended IFRS Standards have not been endorsed by the EU. At 31 December 2018, there were no unendorsed standards effective for the two years ended 31 December 2018 which impact the consolidated financial information of the Group. There were no differences between IFRS Standards endorsed by the EU and IFRS Standards issued by the IASB in terms of their application to the Group.

The Group IFRS accounting policies are the same as those applied for the year ended 31 December 2017 with the exception of the adoption of the new and amended accounting standards as described in note A2.

Exchange rates

The exchange rates applied for balances and transactions in currency other than the presentational currency of the Group, pounds sterling (GBP), were:

Local currency: £	**Closing rate at 31 Dec 2018**	**Average rate for 2018**	**Closing rate at 31 Dec 2017**	**Average rate for 2017**
Hong Kong	**9.97**	**10.46**	10.57	10.04
Indonesia	**18,314.37**	**18,987.65**	18,353.44	17,249.38
Malaysia	**5.26**	**5.38**	5.47	5.54
Singapore	**1.74**	**1.80**	1.81	1.78
China	**8.74**	**8.82**	8.81	8.71
India	**88.92**	**91.25**	86.34	83.90
Vietnam	**29,541.15**	**30,732.53**	30,719.60	29,279.71
Thailand	**41.47**	**43.13**	44.09	43.71
US	**1.27**	**1.34**	1.35	1.29

Certain notes to the financial statements present 2017 comparative information at constant exchange rates (CER), in addition to the reporting at actual exchange rates (AER) used throughout the consolidated financial statements. AER are actual historical exchange rates for the specific accounting period, being the average rates over the period for the income statement and the closing rates for the balance sheet at the balance sheet date. CER results are calculated by translating prior period results using the current period foreign exchange rate, ie current period average rates for the income statement and current period closing rates for the balance sheet.

The financial information set out in this announcement does not constitute the Company's statutory accounts for the years ended 31 December 2018 or 2017 but is derived from those accounts. The auditors have reported on the 2018 statutory accounts. Statutory accounts for 2017 have been delivered to the registrar of companies, and those for 2018 will be delivered following the Company's Annual General Meeting. Their report was (i) unqualified, (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report and (iii) did not contain a statement under section 498(2) or (3) of the Companies Act 2006.

A2 New accounting pronouncements in 2018

IFRS 15, 'Revenue from Contracts with Customers'
The Group has adopted IFRS 15, 'Revenue from Contracts with Customers' from 1 January 2018. This standard provides a single framework to recognise revenue for contracts with different characteristics and overrides the revenue recognition requirements previously provided in other standards. The contracts excluded from the scope of this standard include:

- Lease contracts within the scope of IAS 17, 'Leases';
- Insurance contracts within the scope of IFRS 4, 'Insurance Contracts'; and
- Financial instruments within the scope of IAS 39, 'Financial Instruments'.

The main impacts of IFRS 15 for Prudential are to revenue recognition for asset management contracts and investment contracts that do not contain discretionary participating features but do include investment management services.

In accordance with the transition provisions in IFRS 15, the Group has adopted the standard using the full retrospective method for all periods presented. The only impact on the prior periods presented is a minor reclassification in the consolidated income statement to present certain expenses (such as rebates to clients of asset management fees) as a deduction against revenue. Revenue has been reduced by £234 million in 2018 (2017: £172 million) with a corresponding deduction in expenses.

IFRS 9, 'Financial Instruments' and amendments to IFRS 4, 'Insurance Contracts'
The IASB published a complete version of IFRS 9 in July 2014 with the exception of macro hedge accounting and the standard is mandatorily effective for annual periods beginning on or after 1 January 2018.

In September 2016, the IASB published amendments to IFRS 4, 'Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts' to address the temporary consequences of the different effective dates of IFRS 9 and IFRS 17, 'Insurance Contracts'. The amendments include an optional temporary exemption from applying IFRS 9 and the associated amendments until IFRS 17 comes into effect in 2021. This temporary exemption is available to companies whose predominant activity is to issue insurance contracts based on meeting the eligibility criteria as at 31 December 2015 as set out in the amendments.

The Group met the eligibility criteria for temporary exemption under the amendments to IFRS 4 from applying IFRS 9 and has accordingly deferred the adoption of IFRS 9. See note A3.2 for further details on IFRS 9, including the disclosures associated with the temporary exemption.

In November 2018, the IASB tentatively decided that the effective date of IFRS 17 should be delayed by one year from periods ending on or after 1 January 2021 to 1 January 2022. The IASB also tentatively decided that IFRS 9 could be delayed for insurers by an additional year to keep the effective date of IFRS 9 and IFRS 17 aligned. These changes are yet to be finalised and the Group continues to monitor developments.

Other new accounting pronouncements
In addition to the above, the following new accounting pronouncements are also effective from 1 January 2018:

- IFRIC 22, 'Foreign Currency Transactions and Advance Consideration';
- Classification and measurement of share-based payment transactions (amendments to IFRS 2, 'Share-based payment');
- Transfers of Investment Property (amendments to IAS 40, 'Investment property'); and
- Annual Improvements to IFRSs 2014–2016 Cycle.

These pronouncements have had no effect on the Group's financial statements.

B Earnings performance

B1 Analysis of performance by segment

B1.1 Segment results – profit before tax

	Note	2018 £m	2017 £m AER note (iv)	2017 £m CER note (iv)	2018 vs 2017 % AER note (iv)	2018 vs 2017 % CER note (iv)
Asia:						
Insurance operations	B3(i)	**1,982**	1,799	1,727	10%	15%
Asset management		**182**	176	171	3%	6%
Total Asia		**2,164**	1,975	1,898	10%	14%
US:						
Jackson (US insurance operations)		**1,911**	2,214	2,137	(14)%	(11)%
Asset management		**8**	10	9	(20)%	(11)%
Total US		**1,919**	2,224	2,146	(14)%	(11)%
UK and Europe:						
UK and Europe insurance operations:	B3(iii)					
Long-term business		**1,138**	861	861	32%	32%
General insurance commission[note (i)]		**19**	17	17	12%	12%
Total UK and Europe insurance operations		**1,157**	878	878	32%	32%
UK and Europe asset management[note (v)]	B2	**477**	500	500	(5)%	(5)%
Total UK and Europe		**1,634**	1,378	1,378	19%	19%
Total segment profit		**5,717**	5,577	5,422	3%	5%
Other income and expenditure:						
Investment return and other income		**52**	11	11	373%	373%
Interest payable on core structural borrowings		**(410)**	(425)	(425)	4%	4%
Corporate expenditure[note (ii)]		**(367)**	(361)	(355)	(2)%	(3)%
Total other income and expenditure		**(725)**	(775)	(769)	6%	6%
Restructuring costs		**(165)**	(103)	(103)	(60)%	(60)%
Adjusted IFRS operating profit based on longer-term investment returns		**4,827**	4,699	4,550	3%	6%
Short-term fluctuations in investment returns on shareholder-backed business	B1.2	**(558)**	(1,563)	(1,514)	64%	63%
Amortisation of acquisition accounting adjustments[note (iii)]		**(46)**	(63)	(61)	27%	25%
(Loss) gain on disposal of businesses and corporate transactions	D1.1	**(588)**	223	218	n/a	n/a
Profit before tax		**3,635**	3,296	3,193	10%	14%
Tax charge attributable to shareholders' returns	B4	**(622)**	(906)	(876)	31%	29%
Profit for the year		**3,013**	2,390	2,317	26%	30%
Attributable to:						
Equity holders of the Company		**3,010**	2,389	2,316	26%	30%
Non-controlling interests		**3**	1	1	200%	200%

Basic earnings per share (in pence)	Note	2018	2017 AER note (iv)	2017 CER note (iv)	2018 vs 2017 % AER note (iv)	2018 vs 2017 % CER note (iv)
Based on adjusted IFRS operating profit based on longer-term investment returns[note (vi)]	B5	**156.6p**	145.2p	140.4p	8%	12%
Based on profit for the year	B5	**116.9p**	93.1p	90.0p	26%	30%

Notes

(i) The majority of the general insurance commission is not expected to recur in future years.
(ii) Corporate expenditure as shown above is primarily for Group Head Office and Asia Regional Head Office.
(iii) Amortisation of acquisition accounting adjustments principally relate to the REALIC business of Jackson which was acquired in 2012.
(iv) For definitions of AER and CER refer to note A1. The difference between 'Profit for the year attributable to shareholders' in the prior year on an AER basis and a CER basis is £73 million, arising from the retranslation of the prior year results of the Group's foreign subsidiaries into GBP using the exchange rates applied to the equivalent current year results.

(v) UK and Europe asset management adjusted IFRS operating profit based on longer-term investment returns:

	2018 £m	2017 £m
Asset management fee income	**1,098**	1,027
Other income	**2**	7
Staff costs*	**(384)**	(400)
Other costs*	**(270)**	(202)
Underlying profit before performance-related fees	**446**	432
Share of associate results	**16**	15
Performance-related fees	**15**	53
Total UK and Europe asset management adjusted IFRS operating profit based on longer-term investment returns	**477**	500

* Staff and other costs include £27 million of charges incurred preparing for Brexit.

(vi) Tax charges have been reflected as operating and non-operating in the same way as for the pre-tax items. Further details on tax charges are provided in note B4.

B1.2 Short-term fluctuations in investment returns on shareholder-backed business

	2018 £m	2017 £m
Asia operations	**(512)**	(1)
US operations	**(100)**	(1,568)
UK and Europe operations	**34**	(14)
Other operations	**20**	20
Total	**(558)**	(1,563)

(i) Asia operations

In Asia, the negative short-term fluctuations of £(512) million (2017: negative £(1) million) principally reflect net value movements on assets and related liabilities following increases in bond yields and falls in equity markets during the year, especially in those countries where policyholder liabilities use a valuation interest rate which does not reflect all movements in interest rates in the period.

(ii) US operations

The short-term fluctuations in investment returns for US insurance operations are reported net of the related charge for amortisation of deferred acquisition costs of £(114) million as shown in note C5.2(a) (2017: credit of £462 million) and comprise amounts in respect of the following items:

	2018 £m	2017 £m
Net equity hedge result[note (a)]	**(58)**	(1,490)
Other than equity-related derivatives[note (b)]	**(64)**	(36)
Debt securities[note (c)]	**(31)**	(73)
Equity-type investments: actual less longer-term return	**38**	12
Other items	**15**	19
Total	**(100)**	(1,568)

Notes

(a) Net equity hedge result

The net equity hedge result relates to the accounting effect of market movements on both the value of guarantees in Jackson's variable annuity and fixed index annuity products and on the related derivatives used to manage the exposures inherent in these guarantees. The level of fees recognised in non-operating profit is determined by reference to that allowed for within the reserving basis. The variable annuity guarantees are valued in accordance with either Accounting Standards Codification (ASC) Topic 820, Fair Value Measurements and Disclosures (formerly FAS 157) or ASC Topic 944, Financial Services – Insurance (formerly SOP 03-01) depending on the type of guarantee. Both approaches require an entity to determine the total fee ('the fee assessment') that is expected to fund future projected benefit payments arising using the assumptions applicable for that method. The method under FAS 157 requires this fee assessment to be fixed at the time of issue. As the fees included within the initial fee assessment are earned, they are included in non-operating profit to match the corresponding movement in the guarantee liability. As the Group applies US GAAP for the measured value of the product guarantees this item also includes asymmetric impacts where the measurement bases of the liabilities and associated derivatives used to manage the Jackson annuity business differ as described in note B1.3(c) below.

The net equity hedge result therefore includes significant accounting mismatches and other factors that do not represent the economic result. These other factors include:

- The variable annuity guarantees and fixed index annuity embedded options being only partially fair valued under 'grandfathered' US GAAP as described in note B1.3(c);
- The interest rate exposure being managed through the other than equity-related derivative programme explained in note (b) below; and
- Jackson's management of its economic exposures for a number of other factors that are treated differently in the accounting frameworks such as future fees and assumed volatility levels.

The net equity hedge result (net of related DAC amortisation in accordance with the policy that DAC is amortised in line with emergence of margins) can be summarised as follows:

	2018 £m	2017 £m
Fair value movements on equity hedge instruments*	**299**	(1,871)
Accounting value movements on the variable and fixed index annuity guarantee liabilities†	**(894)**	(99)
Fee assessments net of claim payments	**537**	480
Total	**(58)**	(1,490)

* Held to manage equity exposures of the variable annuity guarantees and fixed index annuity options.

† The accounting value movements on the variable and fixed index annuity guarantee liabilities reflect the impact of market movements and changes in economic and actuarial assumptions. Actuarial assumptions include consideration of persistency, mortality and the expected utilisation of certain features attaching to variable annuity contracts. Assumptions are updated annually via a comparison to experience and after applying expert judgement for how experience may change in the future. Routine updates in 2018 reduced profit before tax (after allowing related changed to DAC amortisation) by £143 million (2017: £382 million).

(b) Other than equity-related derivatives

The fluctuations for this item comprise the net effect of:

- Fair value movements on free-standing, other than equity-related derivatives;
- Fair value movements on the Guaranteed Minimum Income Benefit (GMIB) reinsurance asset that are not matched by movements in the underlying GMIB liability, which is not fair valued as explained in note B1.3; and
- Related amortisation of DAC.

The free-standing, other than equity-related derivatives are held to manage interest rate exposures and durations within the general account and the variable annuity guarantees and fixed index annuity embedded options described in note (a) above. Accounting mismatches arise because of differences between the measurement basis and presentation of the derivatives, which are fair valued with movements recorded in the income statement, and the exposures they are intended to manage.

(c) Short-term fluctuations related to debt securities

	2018 £m	2017 £m
(Charges) credits in the year:		
Losses on sales of impaired and deteriorating bonds	**(4)**	(3)
Bond write-downs	**(4)**	(2)
Recoveries/reversals	**19**	10
Total credits in the year	**11**	5
Risk margin allowance deducted from adjusted IFRS operating profit based on longer-term investment returns*	**77**	86
	88	91
Interest-related realised (losses) gains:		
Losses arising in the year	**(8)**	(43)
Less: Amortisation of gains and losses arising in current and prior years to adjusted IFRS operating profit based on longer-term investment returns	**(116)**	(140)
	(124)	(183)
Related amortisation of deferred acquisition costs	**5**	19
Total short-term fluctuations related to debt securities	**(31)**	(73)

* The debt securities of Jackson are held in the general account of the business. Realised gains and losses are recorded in the income statement with normalised returns included in adjusted IFRS operating profit based on longer-term investment returns with variations from year to year included in the short-term fluctuations category. The risk margin reserve charge for longer-term credit-related losses included in adjusted IFRS operating profit based on longer-term investment returns of Jackson for 2018 is based on an average annual risk margin reserve of 18 basis points (2017: 21 basis points) on average book values of US$57.1 billion (2017: US$55.3 billion) as shown below:

Moody's rating category (or equivalent under NAIC ratings of mortgage-backed securities)

	2018				2017			
	Average book value	RMR	Annual expected loss		Average book value	RMR	Annual expected loss	
	US$m	%	US$m	£m	US$m	%	US$m	£m
A3 or higher	**29,982**	**0.10**	**(31)**	**(23)**	27,277	0.12	(33)	(25)
Baa1, 2 or 3	**25,814**	**0.21**	**(55)**	**(40)**	26,626	0.22	(58)	(45)
Ba1, 2 or 3	**1,042**	**0.98**	**(10)**	**(8)**	1,046	1.03	(11)	(8)
B1, 2 or 3	**289**	**2.64**	**(8)**	**(6)**	318	2.70	(9)	(7)
Below B3	**11**	**3.69**	**–**	**–**	23	3.78	(1)	(1)
Total	**57,138**	**0.18**	**(104)**	**(77)**	55,290	0.21	(112)	(86)
Related amortisation of deferred acquisition costs (see below)			**22**	**15**			21	15
Risk margin reserve charge to adjusted IFRS operating profit for longer-term credit-related losses			**(82)**	**(62)**			(91)	(71)

Consistent with the basis of measurement of insurance assets and liabilities for Jackson's IFRS results, the charges and credits to adjusted IFRS operating profits based on longer-term investment returns are partially offset by related amortisation of deferred acquisition costs.

In addition to the accounting for realised gains and losses described above for Jackson general account debt securities, included within the statement of other comprehensive income is a pre-tax charge of £(1,371) million for net unrealised losses on debt securities classified as available-for-sale net of related amortisation of deferred acquisition costs (2017: credit of £541 million). Temporary market value movements do not reflect defaults or impairments. Additional details of the movement in the value of the Jackson portfolio are included in note C3.2(b).

(iii) UK and Europe operations
The positive short-term fluctuations in investment returns for the UK and Europe operations of £34 million (2017: negative £14 million) mainly arises from unrealised gains on equity options held to hedge the value of future shareholder transfers from the with-profits fund partially offset by losses on corporate bonds backing capital to support the remaining annuity business, given the increase in interest rates and credit spreads in 2018.

(iv) Other operations
The positive short-term fluctuations in investment returns for other operations of £20 million (2017: positive £20 million) include unrealised value movements on financial instruments held outside of the main life operations.

B1.3 Determining operating segments and performance measure of operating segments

Operating segments
The Group's operating segments for financial reporting are defined and presented in accordance with IFRS 8, ‘Operating Segments’, on the basis of the management reporting structure and its financial management information.

Under the Group's management and reporting structure its chief operating decision maker is the Group Executive Committee (GEC). In the management structure, responsibility is delegated to the Chief Executive Officers of Prudential Corporation Asia, the North American Business Unit and M&GPrudential for the day-to-day management of their business units (within the framework set out in the Group Governance Manual). Financial management information used by the GEC aligns with these three business segments. These operating segments derive revenue from both long-term insurance and asset management activities.

Operations which do not form part of any business unit are reported as ‘Unallocated to a segment’. These include Group Head Office and Asia Regional Head Office costs. Prudential Capital and Africa operations do not form part of any operating segment under the structure, and their assets and liabilities and profit or loss before tax are not material to the overall financial position of the Group. Prudential Capital and Africa operations are therefore reported as ‘Unallocated to a segment’.

Performance measure
The performance measure of operating segments utilised by the Company is adjusted IFRS operating profit attributable to shareholders based on longer-term investment returns, as described below. This measurement basis distinguishes adjusted IFRS operating profit based on longer-term investment returns from other constituents of the total profit as follows:

– Short-term fluctuations in investment returns on shareholder-backed business. This includes the impact of short-term market effects on the carrying value of Jackson’s guarantee liabilities and related derivatives as explained below;
– Amortisation of acquisition accounting adjustments arising on the purchase of business. This comprises principally the charge for the adjustments arising on the purchase of REALIC in 2012; and
– Gain or loss on corporate transactions, such as disposals undertaken in the year.

Determination of adjusted IFRS operating profit based on longer-term investment returns for investment and liability movements:

(a) General principles
(i) UK-style with-profits business
The adjusted IFRS operating profit based on longer-term investment returns reflects the statutory transfer gross of attributable tax. Value movements in the underlying assets of the with-profits funds do not affect directly the determination of adjusted IFRS operating profit based on longer-term investment returns.

(ii) Unit-linked business
The policyholder unit liabilities are directly reflective of the underlying asset value movements. Accordingly, the adjusted IFRS operating profit based on longer-term investment returns reflect the current period value movements in both the unit liabilities and the backing assets.

(iii) US variable annuity and fixed index annuity business
This business has guarantee liabilities which are measured on a combination of fair value and other US GAAP derived principles. These liabilities are subject to an extensive derivative programme to manage equity and interest rate exposures whose fair value movements pass through the income statement each period. The principles for determination of the adjusted IFRS operating profit based on longer-term investment returns and short-term fluctuations are as discussed in section (c) below.

(iv) Business where policyholder liabilities are sensitive to market conditions
Under IFRS, the degree to which the carrying values of liabilities to policyholders are sensitive to current market conditions varies between business units depending upon the nature of the ‘grandfathered’ measurement basis. In general, in those instances where the liabilities are particularly sensitive to routine changes in market conditions, the accounting basis is such that the impact of market movements on the assets and liabilities is broadly equivalent in the income statement, and adjusted IFRS operating profit based on longer-term investment returns is not distorted. In these circumstances, there is no need for the movement in the liability to be bifurcated between the elements that relate to longer-term market conditions and short-term effects.

However, movements in liabilities for some types of business do require bifurcation to ensure that at the net level (ie after allocated investment return and charge for policyholder benefits) the adjusted IFRS operating profit based on longer-term investment returns reflects longer-term market returns.

Examples of where such bifurcation is necessary are in Hong Kong and for UK shareholder-backed annuity business, as explained in sections b(i) and d(i), respectively. For other types of Asia's non-participating business, expected longer-term investment returns are used to determine the movement in policyholder liabilities for determining adjusted IFRS operating profit based on longer-term investment returns.

(v) Other shareholder-financed business
For long-term insurance business, where assets and liabilities are held for the long term, the accounting basis for insurance liabilities under current IFRS can lead to profits that include the effects of short-term fluctuations in market conditions, which may not be representative of trends in underlying performance. Therefore, the following key elements are applied to the results of the Group's shareholder-financed businesses to determine adjusted IFRS operating profit based on longer-term investment returns.

Except in the case of assets backing liabilities which are directly matched (such as unit-linked business) or closely correlated with value movements (as discussed below) adjusted IFRS operating profit based on longer-term investment returns for shareholder-financed business is determined on the basis of expected longer-term investment returns. Longer-term investment returns comprise actual income receivable for the period (interest/dividend income) and for both debt and equity-type securities longer-term capital returns.

Debt securities and loans
In principle, for debt securities and loans, the longer-term capital returns comprise two elements:

– Risk margin reserve based charge for the expected level of defaults for the period, which is determined by reference to the credit quality of the portfolio. The difference between impairment losses in the reporting period and the risk margin reserve charge to the adjusted IFRS operating profit based on longer-term investment returns is reflected in short-term fluctuations in investment returns; and
– The amortisation of interest-related realised gains and losses to adjusted IFRS operating profit based on longer-term investment returns to the date when sold bonds would have otherwise matured.

At 31 December 2018, the level of unamortised interest-related realised gains and losses related to previously sold bonds for the Group was a net gain of £629 million (2017: £855 million).

Equity-type securities
For equity-type securities, the longer-term rates of return are estimates of the long-term trend investment returns for income and capital having regard to past performance, current trends and future expectations. Equity-type securities held for shareholder-financed businesses other than the UK annuity business, unit-linked and US variable annuity separate accounts are principally relevant for the US and Asia insurance operations. Different rates apply to different categories of equity-type securities.

Derivative value movements
Generally, derivative value movements are excluded from adjusted IFRS operating profit based on longer-term investment returns. The exception is where the derivative value movements broadly offset changes in the accounting value of other assets and liabilities included in adjusted IFRS operating profit based on longer-term investment returns. The principal example of derivatives whose value movements are excluded from adjusted IFRS operating profit based on longer-term investment returns arises in Jackson, as discussed below in section (c).

(b) Asia insurance operations
(i) Business where policyholder liabilities are sensitive to market conditions
For certain Asia non-participating business, for example in Hong Kong, the economic features are more akin to asset management products with policyholder liabilities reflecting asset shares over the contract term. Consequently, for these products, the charge for policyholder benefits in the adjusted IFRS operating profit based on longer-term investment returns reflects the asset share feature rather than volatile movements that would otherwise be reflected if the local regulatory basis (also applied for IFRS basis) was used.

For certain other types of non-participating business expected longer-term investment returns are used to determine the movement in policyholder liabilities for determining adjusted IFRS operating profit based on longer-term investment returns.

(ii) Other Asia shareholder-financed business
Debt securities
For this business, the realised gains and losses are principally interest related. Accordingly, all realised gains and losses to date for these operations are amortised over the period to the date those securities would otherwise have matured, with no explicit risk margin reserve charge.

Equity-type securities
For Asia insurance operations, investments in equity securities held for non-linked shareholder-backed business amounted to £2,146 million as at 31 December 2018 (31 December 2017: £1,759 million). The rates of return applied in 2018 ranged from 5.3 per cent to 17.6 per cent (2017: 4.3 per cent to 17.2 per cent) with the rates applied varying by business unit. These rates are broadly stable from period to period but may be different between countries reflecting, for example, differing expectations of inflation in each business unit. The assumptions are for the returns expected to apply in equilibrium conditions. The assumed rates of return do not reflect any cyclical variability in economic performance and are not set by reference to prevailing asset valuations.

The longer-term investment returns for the Asia insurance joint ventures accounted for using the equity method are determined on a similar basis as the other Asia insurance operations described above.

(c) US insurance operations

(i) Separate account business

For such business the policyholder unit liabilities are directly reflective of the asset value movements. Accordingly, the adjusted IFRS operating profit based on longer-term investment returns reflect the current period value movements in unit liabilities and the backing assets.

(ii) US variable and fixed index annuity business

The following value movements for Jackson's variable and fixed index annuity business are excluded from adjusted IFRS operating profit based on longer-term investment returns. See note B1.2 note (ii):

- Fair value movements for equity-based derivatives;
- Fair value movements for guaranteed benefit options for the 'not for life' portion of Guaranteed Minimum Withdrawal Benefit (GMWB) and fixed index annuity business, and Guaranteed Minimum Income Benefit (GMIB) reinsurance (see below);
- Movements in the accounts carrying value of Guaranteed Minimum Death Benefit (GMDB), GMIB and the 'for life' portion of GMWB liabilities, (see below) for which, under the 'grandfathered' US GAAP applied under IFRS for Jackson's insurance assets and liabilities, the measurement basis gives rise to a muted impact of current period market movements (ie they are relatively insensitive to the effect of current period equity market and interest rate changes);
- A portion of the fee assessments as well as claim payments, in respect of guarantee liabilities; and
- Related amortisation of deferred acquisition costs for each of the above items.

Guaranteed benefit options for the 'not for life' portion of GMWB and equity index options for the fixed index annuity business

The 'not for life' portion of GMWB guaranteed benefit option liabilities is measured under the US GAAP basis applied for IFRS in a manner consistent with IAS 39 under which the projected future growth rate of the account balance is based on current swap rates (rather than expected rates of return) with only a portion of the expected future guarantee fees included. Reserve value movements on these liabilities are sensitive to changes to levels of equity markets, implied volatility and interest rates. The equity index option for fixed index annuity business is measured under the US GAAP basis applied for IFRS in a manner consistent with IAS 39 under which the projected future growth is based on current swap rates.

Guaranteed benefit option for variable annuity guarantee minimum income benefit

The GMIB liability, which is substantially reinsured, subject to a deductible and annual claim limits, is accounted for using 'grandfathered' US GAAP. This accounting basis substantially does not recognise the effects of market movements. The corresponding reinsurance asset is measured under the 'grandfathered' US GAAP basis applied for IFRS in a manner consistent with IAS 39, 'Financial Instruments: Recognition and Measurement', and the asset is therefore recognised at fair value. As the GMIB is economically reinsured, the mark to market element of the reinsurance asset is included as a component of short-term fluctuations in investment returns.

(iii) Other derivative value movements

The principal example of non-equity based derivatives (for example, interest rate swaps and swaptions) whose value movements are excluded from adjusted IFRS operating profit based on longer-term investment returns, arises in Jackson. Non-equity based derivatives are primarily held by Jackson as part of a broadly-based hedging programme for features of Jackson's bond portfolio (for which value movements are booked in the statement of other comprehensive income rather than the income statement), product liabilities (for which US GAAP accounting as 'grandfathered' under IFRS 4 does not fully reflect the economic features being hedged), and the interest rate exposure attaching to equity-based product options.

(iv) Other US shareholder-financed business

Debt securities

The distinction between impairment losses and interest-related realised gains and losses is of particular relevance to Jackson. Jackson has used the ratings by Nationally Recognised Statistical Ratings Organisations (NRSRO) or ratings resulting from the regulatory ratings detail issued by the National Association of Insurance Commissioners (NAIC) to determine the average annual risk margin reserve to apply to debt securities held to back general account business. Debt securities held to back separate account and reinsurance funds withheld are not subject to risk margin reserve charge. Further details of the risk margin reserve charge, as well as the amortisation of interest-related realised gains and losses, for Jackson are shown in note B1.2 note (ii)(c).

Equity-type securities

As at 31 December 2018, the equity-type securities for US insurance non-separate account operations amounted to £1,359 million (31 December 2017: £946 million). For these operations, the longer-term rates of return for income and capital applied in the years indicated, which reflect the combination of the average risk-free rates over the year and appropriate risk premiums are as follows:

	2018	**2017**
Equity-type securities such as common and preferred stock and portfolio holdings in mutual funds	**6.7% to 7.2%**	6.1% to 6.5%
Other equity-type securities such as investments in limited partnerships and private equity funds	**8.7% to 9.2%**	8.1% to 8.5%

(d) UK and Europe insurance operations

(i) Shareholder-backed annuity business

For this business, policyholder liabilities are determined by reference to current interest rates. The value movements of the assets covering liabilities are closely correlated with the related change in liabilities. Accordingly, asset value movements are recorded within the 'adjusted IFRS operating profit based on longer-term investment returns'. Policyholder liabilities include a margin for credit risk. Variations between actual and best estimate expected impairments are recorded as a component of short-term fluctuations in investment returns.

The adjusted IFRS operating profit based on longer-term investment returns reflects the impact of value movements on policyholder liabilities for shareholder-backed annuity business within The Prudential Assurance Company Limited (PAC) after adjustments to allocate the following elements of the movement to the category of 'short-term fluctuations in investment returns':

– The impact on credit risk provisioning of actual upgrades and downgrades during the period;
– Credit experience compared with assumptions; and
– Short-term value movements on assets backing the capital of the business.

Credit experience reflects the impact of defaults and other similar experience, such as asset exchanges arising from debt restructuring by issuers that include effectively an element of permanent impairment of the security held. Positive or negative experience compared with assumptions is included within short-term fluctuations in investment returns without further adjustment. The effects of other changes to credit risk provisioning are included in the adjusted IFRS operating profit based on longer-term investment returns, as is the net effect of changes to the valuation rate of interest due to portfolio rebalancing to align more closely with management benchmark.

(ii) Non-linked shareholder-financed business

For debt securities backing non-linked shareholder-financed business of the UK and Europe insurance operations (other than the annuity business) the realised gains and losses are principally interest related. Accordingly, all realised gains and losses to date for these operations are being amortised over the period to the date those securities would otherwise have matured, with no explicit risk margin reserve charge.

(e) Fund management and other non-insurance businesses

For these businesses, the particular features applicable for life assurance noted above do not apply and therefore the adjusted IFRS operating profit based on longer-term investment returns is not determined on the basis described above. Instead, realised gains and losses are generally included in adjusted IFRS operating profit based on longer-term investment returns with temporary unrealised gains and losses being included in short-term fluctuations. In some instances, realised gains and losses on derivatives and other financial instruments are amortised to adjusted IFRS operating profit based on longer-term investment returns over a time period that reflects the underlying economic substance of the arrangements.

B2 Acquisition costs and other expenditure

	2018 £m	**2017 £m**
Acquisition costs incurred for insurance policies	**(3,438)**	(3,712)
Acquisition costs deferred less amortisation of acquisition costs	**59**	911
Administration costs and other expenditure*	**(5,380)**	(6,208)
Movements in amounts attributable to external unit holders of consolidated investment funds	**(96)**	(984)
Total acquisition costs and other expenditure	**(8,855)**	(9,993)

* Following the adoption of IFRS 15, the 2017 comparative results have been re-presented as described in note A2. The 2018 administration costs and other expenditure includes a credit of £0.4 billion for the negative ceding commissions arising from the group payout annuity business reinsurance agreement entered into by Jackson with John Hancock Life during the year.

B3 Effect of changes and other accounting matters on insurance assets and liabilities

The following matters are relevant to the determination of the 2018 results:

(i) Asia insurance operations

In 2018, the adjusted IFRS operating profit based on longer-term investment returns for Asia insurance operations included a net credit of £94 million (2017: £75 million) representing a small number of items that are not expected to reoccur, including the non-recurring impact of a refinement to the run-off of the allowance for prudence within technical provisions within Singapore.

(ii) US insurance operations

Changes in the policyholder liabilities held for variable and fixed index annuity guarantees are reported as part of non-operating profit and are as described in note B1.2.

(iii) UK and Europe insurance operations

Allowance for credit risk

For IFRS reporting, the results for UK shareholder-backed annuity business are particularly sensitive to the allowance made for credit risk. The allowance is reflected in the deduction from the valuation rate of interest for discounting projected future annuity payments to policyholders that would have otherwise applied. The credit risk allowance comprises an amount for long-term best estimate defaults and additional provisions for credit risk premium, the cost of downgrades and short-term defaults.

The IFRS credit risk allowance made for the UK shareholder-backed fixed and linked annuity business equated to 40 basis points at 31 December 2018 (31 December 2017: 42 basis points). The allowance represented 22 per cent of the bond spread over swap rates (31 December 2017: 28 per cent).

The reserves for credit risk allowance at 31 December 2018 for the UK shareholder-backed business were £0.9 billion (31 December 2017: £1.6 billion). The 2018 credit risk allowance information is after reflecting the impact of the reinsurance of £12.0 billion of the UK shareholder-backed annuity portfolio to Rothesay Life entered into in March 2018. See note D1.1 for further details.

Other assumption changes

For the shareholder-backed business, in addition to the movement in the credit risk allowance discussed above, the net effect of routine changes to assumptions in 2018 was a credit of £437 million (2017: credit of £173 million).This included, among other items, a benefit to adjusted IFRS operating profit based on longer-term investment returns of £441 million (2017: £204 million), relating to changes to annuitant mortality assumptions to reflect current mortality experience, which has shown a slowdown in life expectancy improvements in recent periods, and the adoption of the Continuous Mortality Investigation (CMI) 2016 model (2017: adoption of 2015 model).

Longevity reinsurance and other management actions

Aside from the aforementioned reinsurance agreement with Rothesay Life, no new longevity reinsurance transactions were undertaken in 2018 (2017: longevity reinsurance transactions covering £0.6 billion of IFRS annuity liabilities contributed £31 million to profit). Other management actions generated profits of £58 million (2017: £245 million).

Review of past annuity sales

Prudential has agreed with the Financial Conduct Authority (FCA) to review annuities sold without advice after 1 July 2008 to its contract-based defined contribution pension customers. The review is examining whether customers were given sufficient information about their potential eligibility to purchase an enhanced annuity, either from Prudential or another pension provider. A gross provision of £400 million, before costs incurred, was established at 31 December 2017 to cover the costs of undertaking the review and any related redress and following a reassessment, no change has been made in 2018. The majority of the provision will be utilised in 2019. The ultimate amount that will be expended by the Group on the review will remain uncertain until the project is completed. If the population subject to redress increased or decreased by 10 per cent, then the provision would be expected to increase or decrease by circa 7 per cent accordingly. Additionally, in 2018, the Group agreed with its professional indemnity insurers that they will meet £166 million of the Group’s claims costs, which will be paid as the Group incurs costs/redress. This has been recognised on the Group’s balance sheet within ‘Other debtors’ at 31 December 2018.

B4 Tax charge

(a) Total tax charge by nature of expense

The total tax charge in the income statement is as follows:

	2018 £m			2017 £m
Tax charge	**Current tax**	**Deferred tax**	**Total**	**Total**
Attributable to shareholders:				
Asia operations	**(199)**	**(78)**	**(277)**	(253)
US operations	**(87)**	**(168)**	**(255)**	(508)
UK and Europe	**(255)**	**39**	**(216)**	(267)
Other operations	**125**	**1**	**126**	122
Tax charge attributable to shareholders' returns	**(416)**	**(206)**	**(622)**	(906)
Attributable to policyholders:				
Asia operations	**(92)**	**12**	**(80)**	(249)
UK and Europe	**(188)**	**594**	**406**	(425)
Tax (charge) credit attributable to policyholders' returns	**(280)**	**606**	**326**	(674)
Total tax charge	**(696)**	**400**	**(296)**	(1,580)

The principal reason for the decrease in the tax charge attributable to shareholders' returns is the inclusion in 2017 of a £445 million deferred tax charge arising on the remeasurement of the US net deferred tax assets from 35 per cent to 21 per cent following the enactment of the US tax reform package, the Tax Cuts and Jobs Act. The movement from a charge of £674 million to a credit of £326 million in the tax charge attributable to policyholders' returns mainly reflects a decrease in the deferred tax liabilities on unrealised gains on investments in the with-profits funds of the UK and Europe and of Asia compared to 2017.

The reconciliation of the expected to actual tax charge attributable to shareholders is provided in (b) below. The tax credit attributable to policyholders of £326 million above is equal to the loss before tax attributable to policyholders of £326 million. This is the result of accounting for policyholder income after the deduction of expenses and movement on unallocated surpluses and on an after-tax basis.

In 2018, a tax charge of £270 million (2017: charge of £93 million) has been taken through other comprehensive income.

(b) Reconciliation of shareholder effective tax rate

In the reconciliation below, the expected tax rates reflect the corporation tax rates that are expected to apply to the taxable profit of the relevant business. Where there are profits of more than one jurisdiction the expected tax rates reflect the corporation tax rates weighted by reference to the amount of profit contributing to the aggregate business result.

	2018 £m					
	Asia operations	**US operations** note (i)	**UK and Europe**	**Other* operations**	**Total attributable to shareholders**	**Percentage impact on ETR**
Adjusted IFRS operating profit (loss) based on longer-term investment returns	**2,164**	**1,919**	**1,634**	**(890)**	**4,827**	
Non-operating loss	**(527)**	**(180)**	**(474)**	**(11)**	**(1,192)**	
Profit (loss) before tax	**1,637**	**1,739**	**1,160**	**(901)**	**3,635**	
Expected tax rate	**22%**	**21%**	**19%**	**19%**	**21%**	
Tax at the expected rate	**360**	**365**	**220**	**(171)**	**774**	**21.3%**
Effects of recurring tax reconciliation items:						
Income not taxable or taxable at concessionary rates	**(34)**	**(17)**	**(6)**	**(2)**	**(59)**	**(1.6)%**
Deductions not allowable for tax purposes	**39**	**3**	**15**	**10**	**67**	**1.8%**
Items related to taxation of life insurance businesses[note (ii)]	**(13)**	**(83)**	**(2)**	**–**	**(98)**	**(2.7)%**
Deferred tax adjustments	**(11)**	**–**	**2**	**(30)**	**(39)**	**(1.1)%**
Effect of results of joint ventures and associates[note (iii)]	**(63)**	**–**	**(3)**	**2**	**(64)**	**(1.8)%**
Irrecoverable withholding taxes[note (iv)]	**–**	**–**	**–**	**47**	**47**	**1.3%**
Other	**(3)**	**–**	**3**	**3**	**3**	**0.1%**
Total	**(85)**	**(97)**	**9**	**30**	**(143)**	**(4.0)%**
Effects of non-recurring tax reconciliation items:						
Adjustments to tax charge in relation to prior years	**–**	**(17)**	**(11)**	**14**	**(14)**	**(0.4)%**
Movements in provisions for open tax matters[note (v)]	**2**	**4**	**(2)**	**1**	**5**	**0.2%**
Total	**2**	**(13)**	**(13)**	**15**	**(9)**	**(0.2)%**
Total actual tax charge (credit)	**277**	**255**	**216**	**(126)**	**622**	**17.1%**
Analysed into:						
Tax on adjusted IFRS operating profit based on longer-term investment returns	**308**	**301**	**313**	**(130)**	**792**	
Tax on non-operating profit	**(31)**	**(46)**	**(97)**	**4**	**(170)**	
Actual tax rate:						
Adjusted IFRS operating profit based on longer-term investment returns:						
Including non-recurring tax reconciling items	**14%**	**16%**	**19%**	**15%**	**16%**	
Excluding non-recurring tax reconciling items	**14%**	**16%**	**20%**	**16%**	**16%**	
Total profit	**17%**	**15%**	**19%**	**14%**	**17%**	

* Other operations include restructuring costs.

Notes

(i) Impact of US tax reform

The 2018 tax charge for US operations reflects the full impact of the US tax reform package, the Tax Cuts and Jobs Act, which was enacted in December 2017 and took effect from 1 January 2018. The expected tax rate of 21 per cent reflects the reduced US corporate income tax rate compared to 35 per cent for 2017. The benefit of the dividend received deduction (shown in Items related to the taxation of life insurance businesses) is lower in 2018 than 2017 reflecting the changes to how this deduction is computed. In 2017, the reduction in the US corporate income tax rate gave rise to a £445 million unfavourable reconciling item in US operations relating to the remeasurement of the net deferred tax asset attributable to shareholders and a £134 million benefit recognised in other comprehensive income.

(ii) Items related to taxation of life insurance businesses

The £83 million (2017: £238 million) reconciling item in US operations reflects the impact of the dividend received deduction on the taxation of profits from variable annuity business. The principal reason for the reduction in the Asia operations reconciling items from £92 million at 2017 to £13 million at 2018 reflects non-operating investment losses in Hong Kong which do not attract tax relief offsetting the benefit of operating profits due to the taxable profit being computed as 5 per cent of net insurance premiums.

(iii) Effects of results of joint ventures and associates

Profit before tax includes Prudential's share of profits after tax from the joint ventures and associates. Therefore, the actual tax charge does not include tax arising from profit or loss of joint ventures and associates and is reflected as a reconciling item in the table above.

(iv) Irrecoverable withholding taxes

The £47 million (2017: £54 million) adverse reconciling items reflects local withholding taxes on dividends paid by certain non-UK subsidiaries, principally Indonesia, to the UK. The dividends are exempt from UK tax and consequently the withholding tax cannot be offset against UK tax payments.

(v) Movements in provisions for open tax matters

The complexity of the tax laws and regulations that relate to our businesses means that from time to time we may disagree with tax authorities on the technical interpretation of a particular area of tax law. This uncertainty means that in the normal course of business the Group will have matters where, upon ultimate resolution of the uncertainty, the amount of profit subject to tax may be greater than the amounts reflected in the Group's submitted tax returns. The statement of financial position contains the following provisions in relation to open tax matters:

	£m
At 31 December 2017	**(139)**
Movements in the current period included in:	
Tax charge attributable to shareholders	**(5)**
Other movements*	**(5)**
At 31 December 2018	**(149)**

* Other movements include interest arising on open tax matters and amounts included in the Group's share of profits from joint ventures and associates, net of related tax.

	2017 £m					
	Asia operations	**US operations**	**UK and Europe**	**Other operations***	**Total attributable to shareholders**	**Percentage impact on ETR**
Adjusted IFRS operating profit (loss) based on longer-term investment returns	1,975	2,224	1,378	(878)	4,699	
Non-operating profit (loss)	53	(1,462)	(14)	20	(1,403)	
Profit (loss) before tax	2,028	762	1,364	(858)	3,296	
Expected tax rate	21%	35%	19%	19%	24%	
Tax at the expected rate	426	267	259	(163)	789	23.9%
Effects of recurring tax reconciliation items:						
Income not taxable or taxable at concessionary rates	(64)	(11)	(2)	(14)	(91)	(2.8)%
Deductions not allowable for tax purposes	26	6	13	10	55	1.7%
Items related to taxation of life insurance businesses	(92)	(238)	(2)	-	(332)	(10.1)%
Deferred tax adjustments	11	17	(1)	(5)	22	0.7%
Effect of results of joint ventures and associates	(52)	-	(3)	-	(55)	(1.7)%
Irrecoverable withholding taxes	-	-	-	54	54	1.6%
Other	(10)	-	6	(1)	(5)	(0.1)%
Total	(181)	(226)	11	44	(352)	(10.7)%
Effects of non-recurring tax reconciliation items:						
Adjustments to tax charge in relation to prior years	(3)	(15)	(3)	(3)	(24)	(0.7)%
Movements in provisions for open tax matters	19	25	-	-	44	1.3%
Impact of US tax reform	-	445	-	-	445	13.5%
Adjustments in relation to business disposals	(8)	12	-	-	4	0.1%
Total	8	467	(3)	(3)	469	14.2%
Total actual tax charge (credit)	253	508	267	(122)	906	27.4%
Analysed into:						
Tax on adjusted IFRS operating profit based on longer-term investment returns	276	548	268	(121)	971	
Tax on non-operating profit	(23)	(40)	(1)	(1)	(65)	
Actual tax rate:						
Adjusted IFRS operating profit based on longer-term investment returns:						
Including non-recurring tax reconciling items	14%	25%	19%	14%	21%	
Excluding non-recurring tax reconciling items	13%	24%	20%	13%	20%	
Total profit	12%	67%	20%	14%	27%	

* Other operations include restructuring costs.

B5 Earnings per share

		2018					
	Note	**Before tax £m** B1.1	**Tax £m** B4	**Non-controlling interests £m**	**Net of tax and non-controlling interests £m**	**Basic earnings per share Pence**	**Diluted earnings per share Pence**
Based on adjusted IFRS operating profit based on longer-term investment returns		**4,827**	**(792)**	**(3)**	**4,032**	**156.6p**	**156.5p**
Short-term fluctuations in investment returns on shareholder-backed business	B1.2	**(558)**	**53**	**–**	**(505)**	**(19.7)p**	**(19.7)p**
Amortisation of acquisition accounting adjustments		**(46)**	**9**	**–**	**(37)**	**(1.4)p**	**(1.4)p**
Loss on disposal of businesses and corporate transactions	D1.1	**(588)**	**108**	**–**	**(480)**	**(18.6)p**	**(18.6)p**
Based on profit for the year		**3,635**	**(622)**	**(3)**	**3,010**	**116.9p**	**116.8p**

		2017					
	Note	**Before tax £m** B1.1	**Tax £m** B4	**Non-controlling interests £m**	**Net of tax and non-controlling interests £m**	**Basic earnings per share Pence**	**Diluted earnings per share Pence**
Based on adjusted IFRS operating profit based on longer-term investment returns		4,699	(971)	(1)	3,727	145.2p	145.1p
Short-term fluctuations in investment returns on shareholder-backed business	B1.2	(1,563)	572	–	(991)	(38.6)p	(38.6)p
Amortisation of acquisition accounting adjustments		(63)	20	–	(43)	(1.7)p	(1.7)p
Cumulative exchange gain on the sold Korea life business recycled from other comprehensive income		61	–	–	61	2.4p	2.4p
Profit attaching to the disposal of businesses	D1.1	162	(82)	–	80	3.1p	3.1p
Impact of US tax reform	B4	–	(445)	–	(445)	(17.3)p	(17.3)p
Based on profit for the year		3,296	(906)	(1)	2,389	93.1p	93.0p

Earnings per share are calculated based on earnings attributable to ordinary shareholders, after related tax and non-controlling interests.

The weighted average number of shares for calculating earnings per share, which excludes those held in employee share trusts and consolidated unit trusts and OEICs, is set out as below:

	2018	**2017**
Weighted average number (in millions) of shares for calculation of:		
Basic earnings per share	**2,575**	2,567
Shares under option at end of year	**5**	6
Number of shares that would have been issued at fair value on assumed option price	**(4)**	(5)
Diluted earnings per share	**2,576**	2,568

B6 Dividends

	2018		2017	
	Pence per share	**£m**	**Pence per share**	**£m**
Dividends relating to reporting year:				
First interim ordinary dividend	**15.67p**	**406**	14.50p	375
Second interim ordinary dividend	**33.68p**	**873**	32.50p	841
Total	**49.35p**	**1,279**	47.00p	1,216
Dividends paid in reporting year:				
Current year first interim ordinary dividend	**15.67p**	**404**	14.50p	373
Second interim ordinary dividend for prior year	**32.50p**	**840**	30.57p	786
Total	**48.17p**	**1,244**	45.07p	1,159

Dividend per share

For the year ended 31 December 2017 the second interim ordinary dividend of 32.50 pence per ordinary share was paid to eligible shareholders on 18 May 2018. The 2018 first interim ordinary dividend of 15.67 pence per ordinary share was paid to eligible shareholders on 27 September 2018.

The second interim ordinary dividend for the year ended 31 December 2018 of 33.68 pence per ordinary share will be paid on 17 May 2019 in sterling to shareholders on the UK register and the Irish branch register on 29 March 2019 (Record Date), and in Hong Kong dollars to shareholders on the Hong Kong branch register at 4.30pm Hong Kong time on the Record Date (HK Shareholders). Holders of US American Depositary Receipts (US Shareholders) will be paid their dividends in US dollars on or about 24 May 2019. The second interim ordinary dividend will be paid on or about 24 May 2019 in Singapore dollars to shareholders with shares standing to the credit of their securities accounts with The Central Depository (Pte) Limited (CDP) at 5.00pm Singapore time on the Record Date (SG Shareholders). The dividend payable to the HK Shareholders will be translated using the exchange rate quoted by the WM Company at the close of business on 12 March 2019. The exchange rate at which the dividend payable to the SG Shareholders will be translated into Singapore dollars, will be determined by CDP.

Shareholders on the UK register and Irish branch register are eligible to participate in a Dividend Reinvestment Plan.

C Balance sheet notes

C1 Analysis of Group statement of financial position by segment

		31 Dec 2018 £m						31 Dec 2017 £m
By operating segment	Note	Asia C2.1	US C2.2	UK and Europe C2.3	Unallocated to a segment (central operations) note	Elimination of intra-group debtors and creditors	Group total	Group total
Assets								
Goodwill	C5.1	**498**	**–**	**1,359**	**–**	**–**	**1,857**	1,482
Deferred acquisition costs and other intangible assets	C5.2	**2,937**	**8,747**	**195**	**44**	**–**	**11,923**	11,011
Property, plant and equipment		**129**	**246**	**1,031**	**3**	**–**	**1,409**	789
Reinsurers' share of insurance contract liabilities		**2,777**	**6,662**	**2,812**	**2**	**(1,109)**	**11,144**	9,673
Deferred tax assets	C8	**119**	**2,295**	**126**	**55**	**–**	**2,595**	2,627
Current tax recoverable		**26**	**311**	**244**	**118**	**(81)**	**618**	613
Accrued investment income		**664**	**498**	**1,511**	**76**	**–**	**2,749**	2,676
Other debtors		**2,978**	**238**	**4,189**	**1,968**	**(5,285)**	**4,088**	2,963
Investment properties		**5**	**6**	**17,914**	**–**	**–**	**17,925**	16,497
Investment in joint ventures and associates accounted for using the equity method		**991**	**–**	**742**	**–**	**–**	**1,733**	1,416
Loans	C3.3	**1,377**	**11,066**	**5,567**	**–**	**–**	**18,010**	17,042
Equity securities and portfolio holdings in unit trusts		**32,150**	**128,657**	**53,810**	**116**	**–**	**214,733**	223,391
Debt securities	C3.2	**45,839**	**41,594**	**85,956**	**1,967**	**–**	**175,356**	171,374
Derivative assets		**296**	**574**	**2,513**	**111**	**–**	**3,494**	4,801
Other investments		**–**	**927**	**5,585**	**–**	**–**	**6,512**	5,622
Deposits		**1,224**	**92**	**10,320**	**160**	**–**	**11,796**	11,236
Assets held for sale*		**–**	**–**	**10,578**	**–**	**–**	**10,578**	38
Cash and cash equivalents		**2,189**	**3,005**	**4,749**	**2,182**	**–**	**12,125**	10,690
Total assets		**94,199**	**204,918**	**209,201**	**6,802**	**(6,475)**	**508,645**	493,941
Total equity		**6,428**	**5,624**	**8,700**	**(3,485)**	**–**	**17,267**	16,094
Liabilities								
Insurance contract liabilities	C4.1	**72,349**	**182,432**	**68,957**	**37**	**(1,109)**	**322,666**	328,172
Investment contract liabilities with discretionary participation features	C4.1	**375**	**–**	**67,038**	**–**	**–**	**67,413**	62,677
Investment contract liabilities without discretionary participation features	C4.1	**492**	**3,168**	**15,560**	**2**	**–**	**19,222**	20,394
Unallocated surplus of with-profits funds	C4.1	**2,511**	**–**	**13,334**	**–**	**–**	**15,845**	16,951
Core structural borrowings of shareholder-financed businesses	C6.1	**–**	**196**	**–**	**7,468**	**–**	**7,664**	6,280
Operational borrowings attributable to shareholder-financed businesses	C6.2	**61**	**328**	**106**	**503**	**–**	**998**	1,791
Borrowings attributable to with-profits businesses	C6.2	**19**	**–**	**3,921**	**–**	**–**	**3,940**	3,716
Obligations under funding, securities lending and sale and repurchase agreements		**–**	**5,765**	**1,224**	**–**	**–**	**6,989**	5,662
Net asset value attributable to unit holders of consolidated unit trusts and similar funds		**2,617**	**–**	**9,013**	**21**	**–**	**11,651**	8,889
Deferred tax liabilities	C8	**1,257**	**1,688**	**1,061**	**16**	**–**	**4,022**	4,715
Current tax liabilities		**133**	**115**	**326**	**75**	**(81)**	**568**	537
Accruals, deferred income and other liabilities		**7,641**	**5,324**	**6,442**	**1,126**	**(5,285)**	**15,248**	14,185
Provisions		**251**	**23**	**743**	**61**	**–**	**1,078**	1,123
Derivative liabilities		**65**	**255**	**2,208**	**978**	**–**	**3,506**	2,755
Liabilities held for sale*		**–**	**–**	**10,568**	**–**	**–**	**10,568**	–
Total liabilities		**87,771**	**199,294**	**200,501**	**10,287**	**(6,475)**	**491,378**	477,847
Total equity and liabilities		**94,199**	**204,918**	**209,201**	**6,802**	**(6,475)**	**508,645**	493,941

* Assets held for sale of £10,578 million includes £10,568 million in respect of the reinsured UK annuity business. The corresponding policyholder and other liabilities of £10,568 million is reflected in liabilities held for sale (see note D1.1).

Note

Unallocated to a segment includes central operations, Prudential Capital and Africa operations as per note B1.3.

C2 Analysis of segment statement of financial position by business type

C2.1 Asia

		31 Dec 2018 £m							31 Dec 2017 £m
		Insurance							
	Note	With-profits business*	Unit-linked assets and liabilities	Other business	Total	Asset management	Eliminations	Total	Total
Assets									
Goodwill		**–**	**–**	**251**	**251**	**247**	**–**	**498**	305
Deferred acquisition costs and other intangible assets		**56**	**–**	**2,870**	**2,926**	**11**	**–**	**2,937**	2,540
Property, plant and equipment		**90**	**–**	**34**	**124**	**5**	**–**	**129**	125
Reinsurers' share of insurance contract liabilities		**63**	**–**	**2,714**	**2,777**	**–**	**–**	**2,777**	1,960
Deferred tax assets		**–**	**1**	**108**	**109**	**10**	**–**	**119**	112
Current tax recoverable		**–**	**2**	**23**	**25**	**1**	**–**	**26**	58
Accrued investment income		**254**	**51**	**327**	**632**	**32**	**–**	**664**	595
Other debtors		**1,676**	**730**	**535**	**2,941**	**77**	**(40)**	**2,978**	2,675
Investment properties		**–**	**–**	**5**	**5**	**–**	**–**	**5**	5
Investment in joint ventures and associates accounted for using the equity method		**–**	**–**	**827**	**827**	**164**	**–**	**991**	912
Loans	C3.3	**792**	**–**	**585**	**1,377**	**–**	**–**	**1,377**	1,317
Equity securities and portfolio holdings in unit trusts		**17,165**	**12,804**	**2,146**	**32,115**	**35**	**–**	**32,150**	29,976
Debt securities	C3.2	**27,204**	**3,981**	**14,583**	**45,768**	**71**	**–**	**45,839**	40,982
Derivative assets		**201**	**4**	**91**	**296**	**–**	**–**	**296**	113
Deposits		**250**	**455**	**458**	**1,163**	**61**	**–**	**1,224**	1,291
Cash and cash equivalents		**870**	**326**	**874**	**2,070**	**119**	**–**	**2,189**	1,934
Total assets		**48,621**	**18,354**	**26,431**	**93,406**	**833**	**(40)**	**94,199**	84,900
Total equity		**–**	**–**	**5,868**	**5,868**	**560**	**–**	**6,428**	5,926
Liabilities									
Insurance contract liabilities		**40,389**	**15,876**	**16,084**	**72,349**	**–**	**–**	**72,349**	63,468
Investment contract liabilities with discretionary participation features	C4.1(b)	**375**	**–**	**–**	**375**	**–**	**–**	**375**	337
Investment contract liabilities without discretionary participation features	C4.1(b)	**–**	**492**	**–**	**492**	**–**	**–**	**492**	328
Unallocated surplus of with-profits funds		**2,511**	**–**	**–**	**2,511**	**–**	**–**	**2,511**	3,474
Operational borrowings attributable to shareholder-financed businesses		**–**	**50**	**11**	**61**	**–**	**–**	**61**	50
Borrowings attributable to with-profits businesses		**19**	**–**	**–**	**19**	**–**	**–**	**19**	10
Net asset value attributable to unit holders of consolidated unit trusts and similar funds		**1,242**	**1,024**	**351**	**2,617**	**–**	**–**	**2,617**	3,631
Deferred tax liabilities		**812**	**21**	**422**	**1,255**	**2**	**–**	**1,257**	1,152
Current tax liabilities		**27**	**–**	**93**	**120**	**13**	**–**	**133**	122
Accruals, deferred income and other liabilities		**3,138**	**889**	**3,475**	**7,502**	**179**	**(40)**	**7,641**	6,069
Provisions		**57**	**–**	**115**	**172**	**79**	**–**	**251**	254
Derivative liabilities		**51**	**2**	**12**	**65**	**–**	**–**	**65**	79
Total liabilities		**48,621**	**18,354**	**20,563**	**87,538**	**273**	**(40)**	**87,771**	78,974
Total equity and liabilities		**48,621**	**18,354**	**26,431**	**93,406**	**833**	**(40)**	**94,199**	84,900

* The statement of financial position for with-profits business comprises the with-profits assets and liabilities of the Hong Kong, Malaysia and Singapore operations. Assets and liabilities of other participating business are included in the column for 'Other business'.

C2.2 US

		31 Dec 2018 £m						31 Dec 2017 £m
		Insurance						
	Note	Variable annuity separate account assets and liabilities	Fixed annuity, GICs and other business	Total	Asset management	Eliminations	Total	Total
Assets								
Goodwill		–	–	–	–	–	–	–
Deferred acquisition costs and other intangible assets		–	8,747	8,747	–	–	8,747	8,219
Property, plant and equipment		–	243	243	3	–	246	214
Reinsurers' share of insurance contract liabilities		–	6,662	6,662	–	–	6,662	6,424
Deferred tax assets		–	2,271	2,271	24	–	2,295	2,300
Current tax recoverable		–	309	309	2	–	311	298
Accrued investment income		–	493	493	5	–	498	492
Other debtors		–	230	230	76	(68)	238	248
Investment properties		–	6	6	–	–	6	5
Loans	C3.3	–	11,066	11,066	–	–	11,066	9,630
Equity securities and portfolio holdings in unit trusts		128,220	433	128,653	4	–	128,657	130,630
Debt securities	C3.2	–	41,594	41,594	–	–	41,594	35,378
Derivative assets		–	574	574	–	–	574	1,611
Other investments		–	926	926	1	–	927	848
Deposits		–	–	–	92	–	92	43
Cash and cash equivalents		–	2,976	2,976	29	–	3,005	1,658
Total assets		128,220	76,530	204,750	236	(68)	204,918	197,998
Total equity		–	5,584	5,584	40	–	5,624	5,248
Liabilities								
Insurance contract liabilities		128,220	54,212	182,432	–	–	182,432	177,728
Investment contract liabilities without discretionary participation features	C4.1(c)	–	3,168	3,168	–	–	3,168	2,996
Core structural borrowings of shareholder-financed businesses		–	196	196	–	–	196	184
Operational borrowings attributable to shareholder-financed businesses		–	328	328	–	–	328	508
Obligations under funding, securities lending and sale and repurchase agreements		–	5,765	5,765	–	–	5,765	4,304
Net asset value attributable to unit holders of consolidated unit trusts and similar funds		–	–	–	–	–	–	–
Deferred tax liabilities		–	1,688	1,688	–	–	1,688	1,845
Current tax liabilities		–	114	114	1	–	115	47
Accruals, deferred income and other liabilities		–	5,197	5,197	195	(68)	5,324	5,109
Provisions		–	23	23	–	–	23	24
Derivative liabilities		–	255	255	–	–	255	5
Total liabilities		128,220	70,946	199,166	196	(68)	199,294	192,750
Total equity and liabilities		128,220	76,530	204,750	236	(68)	204,918	197,998

C2.3 UK and Europe

	Note	31 Dec 2018 £m Insurance With-profits business*	Insurance Other funds and subsidiaries Unit-linked assets and liabilities	Insurance Other funds and subsidiaries Annuity and other long-term business	Insurance Total	Asset management	Eliminations	Total	31 Dec 2017 £m Total
Assets									
Goodwill		**206**	**–**	**–**	**206**	**1,153**	**–**	**1,359**	1,177
Deferred acquisition costs and other intangible assets		**83**	**–**	**94**	**177**	**18**	**–**	**195**	210
Property, plant and equipment		**895**	**–**	**39**	**934**	**97**	**–**	**1,031**	447
Reinsurers' share of insurance contract liabilities		**1,131**	**115**	**1,566**	**2,812**	**–**	**–**	**2,812**	2,521
Deferred tax assets		**61**	**–**	**45**	**106**	**20**	**–**	**126**	157
Current tax recoverable		**58**	**6**	**174**	**238**	**6**	**–**	**244**	244
Accrued investment income		**1,010**	**116**	**378**	**1,504**	**7**	**–**	**1,511**	1,558
Other debtors		**2,102**	**575**	**641**	**3,318**	**1,011**	**(140)**	**4,189**	3,118
Investment properties		**15,635**	**618**	**1,661**	**17,914**	**–**	**–**	**17,914**	16,487
Investment in joint ventures and associates accounted for using the equity method		**705**	**–**	**–**	**705**	**37**	**–**	**742**	504
Loans	C3.3	**3,853**	**–**	**1,714**	**5,567**	**–**	**–**	**5,567**	5,986
Equity securities and portfolio holdings in unit trusts		**41,090**	**12,477**	**20**	**53,587**	**223**	**–**	**53,810**	62,670
Debt securities	C3.2	**53,798**	**10,512**	**21,646**	**85,956**	**–**	**–**	**85,956**	92,707
Derivative assets		**1,957**	**1**	**555**	**2,513**	**–**	**–**	**2,513**	2,954
Other investments		**5,573**	**10**	**1**	**5,584**	**1**	**–**	**5,585**	4,774
Deposits		**8,530**	**1,101**	**689**	**10,320**	**–**	**–**	**10,320**	9,540
Assets held for sale		**10**	**–**	**10,568**	**10,578**	**–**	**–**	**10,578**	38
Cash and cash equivalents		**3,520**	**190**	**688**	**4,398**	**351**	**–**	**4,749**	5,808
Total assets		**140,217**	**25,721**	**40,479**	**206,417**	**2,924**	**(140)**	**209,201**	210,900
Total equity		**–**	**–**	**6,540**	**6,540**	**2,160**	**–**	**8,700**	8,245
Liabilities									
Insurance contract liabilities	C4.1(d)	**43,775**	**5,219**	**19,963**	**68,957**	**–**	**–**	**68,957**	88,180
Investment contract liabilities with discretionary participation features	C4.1(d)	**67,018**	**–**	**20**	**67,038**	**–**	**–**	**67,038**	62,340
Investment contract liabilities without discretionary participation features	C4.1(d)	**2**	**15,498**	**60**	**15,560**	**–**	**–**	**15,560**	17,069
Unallocated surplus of with-profits funds		**13,334**	**–**	**–**	**13,334**	**–**	**–**	**13,334**	13,477
Operational borrowings attributable to shareholder-financed businesses		**–**	**4**	**102**	**106**	**–**	**–**	**106**	148
Borrowings attributable to with-profits businesses		**3,921**	**–**	**–**	**3,921**	**–**	**–**	**3,921**	3,706
Obligations under funding, securities lending and sale and repurchase agreements		**999**	**–**	**225**	**1,224**	**–**	**–**	**1,224**	1,358
Net asset value attributable to unit holders of consolidated unit trusts and similar funds		**4,349**	**4,643**	**21**	**9,013**	**–**	**–**	**9,013**	5,243
Deferred tax liabilities		**892**	**–**	**147**	**1,039**	**22**	**–**	**1,061**	1,703
Current tax liabilities		**29**	**–**	**269**	**298**	**28**	**–**	**326**	377
Accruals deferred income and other liabilities		**4,601**	**354**	**1,141**	**6,096**	**486**	**(140)**	**6,442**	6,609
Provisions		**32**	**–**	**484**	**516**	**227**	**–**	**743**	784
Derivative liabilities		**1,265**	**3**	**939**	**2,207**	**1**	**–**	**2,208**	1,661
Liabilities held for sale		**–**	**–**	**10,568**	**10,568**	**–**	**–**	**10,568**	–
Total liabilities		**140,217**	**25,721**	**33,939**	**199,877**	**764**	**(140)**	**200,501**	202,655
Total equity and liabilities		**140,217**	**25,721**	**40,479**	**206,417**	**2,924**	**(140)**	**209,201**	210,900

* Includes the Scottish Amicable Insurance Fund which, at 31 December 2018, had total assets and liabilities of £4,844 million (2017: £5,768 million). The PAC with-profits sub-fund (WPSF) mainly contains with-profits business but it also contains some non-profit business (unit-linked, term assurances and annuities). The UK with-profits fund includes £9.5 billion (2017: £10.6 billion) of non-profits annuities liabilities.

C3 Assets and liabilities

C3.1 Group assets and liabilities – measurement

(a) Determination of fair value

The fair values of the financial instruments for which fair valuation is required under IFRS are determined by the use of current market bid prices for exchange-quoted investments or by using quotations from independent third parties such as brokers and pricing services or by using appropriate valuation techniques.

The estimated fair value of derivative financial instruments reflects the estimated amount the Group would receive or pay in an arm's-length transaction. This amount is determined using quoted prices if exchange listed, quotations from independent third parties or valued internally using standard market practices.

Other than the loans which have been designated at fair value through profit or loss, the loans and receivables have been shown net of provisions for impairment. The fair value of loans have been estimated from discounted cash flows expected to be received. The discount rate is updated for the market rate of interest where applicable.

The fair value of investment properties is based on market values as assessed by professionally qualified external valuers or by the Group's qualified surveyors.

The fair value of the subordinated and senior debt issued by the parent company is determined using quoted prices from independent third parties.

The fair value of financial liabilities (other than derivative financial instruments) is determined using discounted cash flows of the amounts expected to be paid.

(b) Fair value measurement hierarchy of Group assets and liabilities

Assets and liabilities carried at fair value on the statement of financial position

The table below shows the assets and liabilities carried at fair value analysed by level of the IFRS 13, 'Fair Value Measurement' defined fair value hierarchy. This hierarchy is based on the inputs to the fair value measurement and reflects the lowest level input that is significant to that measurement.

Financial instruments at fair value

	31 Dec 2018 £m			
	Level 1	**Level 2**	**Level 3**	
	Quoted prices (unadjusted) in active markets	**Valuation based on significant observable market inputs**	**Valuation based on significant unobservable market inputs**	**Total**
Analysis of financial investments, net of derivative liabilities by business type				
With-profits				
Loans	**–**	**–**	**1,703**	**1,703**
Equity securities and portfolio holdings in unit trusts	**52,320**	**5,447**	**488**	**58,255**
Debt securities	**31,210**	**48,981**	**811**	**81,002**
Other investments (including derivative assets)	**143**	**3,263**	**4,325**	**7,731**
Derivative liabilities	**(85)**	**(1,231)**	**–**	**(1,316)**
Total financial investments, net of derivative liabilities	**83,588**	**56,460**	**7,327**	**147,375**
Percentage of total	**57%**	**38%**	**5%**	**100%**
Unit-linked and variable annuity separate account				
Equity securities and portfolio holdings in unit trusts	**152,987**	**505**	**9**	**153,501**
Debt securities	**4,766**	**9,727**	**–**	**14,493**
Other investments (including derivative assets)	**6**	**3**	**6**	**15**
Derivative liabilities	**(2)**	**(3)**	**–**	**(5)**
Total financial investments, net of derivative liabilities	**157,757**	**10,232**	**15**	**168,004**
Percentage of total	**94%**	**6%**	**0%**	**100%**
Non-linked shareholder-backed				
Loans	**–**	**–**	**3,050**	**3,050**
Equity securities and portfolio holdings in unit trusts	**2,957**	**2**	**18**	**2,977**
Debt securities	**17,687**	**61,803**	**371**	**79,861**
Other investments (including derivative assets)	**61**	**1,258**	**941**	**2,260**
Derivative liabilities	**(2)**	**(1,760)**	**(423)**	**(2,185)**
Total financial investments, net of derivative liabilities	**20,703**	**61,303**	**3,957**	**85,963**
Percentage of total	**24%**	**71%**	**5%**	**100%**
Group total analysis, including other financial liabilities held at fair value				
Loans	**–**	**–**	**4,753**	**4,753**
Equity securities and portfolio holdings in unit trusts	**208,264**	**5,954**	**515**	**214,733**
Debt securities	**53,663**	**120,511**	**1,182**	**175,356**
Other investments (including derivative assets)	**210**	**4,524**	**5,272**	**10,006**
Derivative liabilities	**(89)**	**(2,994)**	**(423)**	**(3,506)**
Total financial investments, net of derivative liabilities	**262,048**	**127,995**	**11,299**	**401,342**
Investment contract liabilities without discretionary participation features held at fair value	**–**	**(16,054)**	**–**	**(16,054)**
Borrowings attributable to with-profits businesses	**–**	**–**	**(1,606)**	**(1,606)**
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	**(6,852)**	**(3,811)**	**(988)**	**(11,651)**
Other financial liabilities held at fair value	**–**	**(2)**	**(3,404)**	**(3,406)**
Total financial instruments at fair value	**255,196**	**108,128**	**5,301**	**368,625**
Percentage of total	**70%**	**29%**	**1%**	**100%**

	31 Dec 2017 £m			
	Level 1	Level 2	Level 3	
	Quoted prices (unadjusted) in active markets	Valuation based on significant observable market inputs	Valuation based on significant unobservable market inputs	Total
Analysis of financial investments, net of derivative liabilities by business type				
With-profits				
Loans	–	–	2,023	2,023
Equity securities and portfolio holdings in unit trusts	57,347	4,470	351	62,168
Debt securities	29,143	45,602	348	75,093
Other investments (including derivative assets)	68	3,638	3,540	7,246
Derivative liabilities	(68)	(615)	–	(683)
Total financial investments, net of derivative liabilities	86,490	53,095	6,262	145,847
Percentage of total	60%	36%	4%	100%
Unit-linked and variable annuity separate account				
Equity securities and portfolio holdings in unit trusts	158,631	457	10	159,098
Debt securities	4,993	5,226	–	10,219
Other investments (including derivative assets)	12	4	8	24
Derivative liabilities	–	(1)	–	(1)
Total financial investments, net of derivative liabilities	163,636	5,686	18	169,340
Percentage of total	97%	3%	0%	100%
Non-linked shareholder-backed				
Loans	–	–	2,814	2,814
Equity securities and portfolio holdings in unit trusts	2,105	10	10	2,125
Debt securities	21,443	64,313	306	86,062
Other investments (including derivative assets)	7	2,270	876	3,153
Derivative liabilities	–	(1,559)	(512)	(2,071)
Total financial investments, net of derivative liabilities	23,555	65,034	3,494	92,083
Percentage of total	25%	71%	4%	100%
Group total analysis, including other financial liabilities held at fair value				
Loans	–	–	4,837	4,837
Equity securities and portfolio holdings in unit trusts	218,083	4,937	371	223,391
Debt securities	55,579	115,141	654	171,374
Other investments (including derivative assets)	87	5,912	4,424	10,423
Derivative liabilities	(68)	(2,175)	(512)	(2,755)
Total financial investments, net of derivative liabilities	273,681	123,815	9,774	407,270
Investment contract liabilities without discretionary participation features held at fair value	–	(17,397)	–	(17,397)
Borrowings attributable to with-profits businesses	–	–	(1,887)	(1,887)
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	(4,836)	(3,640)	(413)	(8,889)
Other financial liabilities held at fair value	–	–	(3,031)	(3,031)
Total financial instruments at fair value	268,845	102,778	4,443	376,066
Percentage of total	72%	27%	1%	100%

All assets and liabilities held at fair value are classified as fair value through profit or loss, except for £40,849 million (31 December 2017: £35,293 million) of debt securities classified as available-for-sale.

Investment properties at fair value

	31 Dec £m			
	Level 1	Level 2	Level 3	
	Quoted prices (unadjusted) in active markets	Valuation based on significant observable market inputs	Valuation based on significant unobservable market inputs	Total
2018	**–**	**–**	**17,925**	**17,925**
2017	–	–	16,497	16,497

(c) Valuation approach for level 2 fair valued assets and liabilities

A significant proportion of the Group's level 2 assets are corporate bonds, structured securities and other non-national government debt securities. These assets, in line with market practice, are generally valued using a designated independent pricing service or quote from third-party brokers. These valuations are subject to a number of monitoring controls, such as comparison to multiple pricing sources where available, monthly price variances, stale price reviews and variance analysis on prices achieved on subsequent trades.

When prices are not available from pricing services, quotes are sourced directly from brokers. Prudential seeks to obtain a number of quotes from different brokers so as to obtain the most comprehensive information available on their executability. Where quotes are sourced directly from brokers, the price used in the valuation is normally selected from one of the quotes based on a number of factors, including the timeliness and regularity of the quotes and the accuracy of the quotes considering the spreads provided. The selected quote is the one which best represents an executable quote for the security at the measurement date.

Generally, no adjustment is made to the prices obtained from independent third parties. Adjustment is made in only limited circumstances, where it is determined that the third-party valuations obtained do not reflect fair value (eg either because the value is stale and/or the values are extremely diverse in range). These are usually securities which are distressed or that could be subject to a debt restructure or where reliable market prices are no longer available due to an inactive market or market dislocation. In these instances, prices are derived using internal valuation techniques including those as described below in this note with the objective of arriving at a fair value measurement that reflects the price at which an orderly transaction would take place between market participants on the measurement date. The techniques used require a number of assumptions relating to variables such as credit risk and interest rates. Examples of such variables include an average credit spread based on the corporate bond universe and the relevant duration of the asset being valued. Prudential determines the input assumptions based on the best available information at the measurement dates. Securities valued in such manner are classified as level 3 where these significant inputs are not based on observable market data.

Of the total level 2 debt securities of £120,511 million at 31 December 2018 (31 December 2017: £115,141 million), £15,425 million are valued internally (31 December 2017: £13,910 million). The majority of such securities are valued using matrix pricing, which is based on assessing the credit quality of the underlying borrower to derive a suitable discount rate relative to government securities of a comparable duration. Under matrix pricing, the debt securities are priced taking the credit spreads on comparable quoted public debt securities and applying these to the equivalent debt instruments factoring in a specified liquidity premium. The majority of the parameters used in this valuation technique are readily observable in the market and, therefore, are not subject to interpretation.

(d) Fair value measurements for level 3 fair valued assets and liabilities

Valuation approach for level 3 fair valued assets and liabilities
Financial instruments at fair value
Investments valued using valuation techniques include financial investments which by their nature do not have an externally quoted price based on regular trades, and financial investments for which markets are no longer active as a result of market conditions, eg market illiquidity. The valuation techniques used include comparison to recent arm's-length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option adjusted spread models and, if applicable, enterprise valuation. These techniques may include a number of assumptions relating to variables such as credit risk and interest rates. Changes in assumptions relating to these variables could positively or negatively impact the reported fair value of these instruments. When determining the inputs into the valuation techniques used priority is given to publicly available prices from independent sources when available, but overall the source of pricing is chosen with the objective of arriving at a fair value measurement that reflects the price at which an orderly transaction would take place between market participants on the measurement date.

The fair value estimates are made at a specific point in time, based upon available market information and judgements about the financial instruments, including estimates of the timing and amount of expected future cash flows and the credit standing of counterparties. Such estimates do not reflect any premium or discount that could result from offering for sale at one time a significant volume of a particular financial instrument, nor do they consider the tax impact of the realisation of unrealised gains or losses from selling the financial instrument being fair valued.

In accordance with the Group's risk management framework, the estimated fair value of derivative financial instruments valued internally using standard market practices are subject to assessment against external counterparties' valuations.

At 31 December 2018, the Group held £5,301 million (31 December 2017: £4,443 million) of net financial instruments at fair value within level 3. This represents 1 per cent (31 December 2017: 1 per cent) of the total fair valued financial assets net of fair valued financial liabilities. The principal financial assets, net of corresponding liabilities, classified as fair value within level 3 as of 31 December 2018 are described below:

(i) £1,702 million of loans (31 December 2017: £1,983 million) and a corresponding £1,606 million (31 December 2017: £1,887 million) of borrowings are held by a subsidiary of the Group's UK with-profits fund, attaching to a portfolio of buy-to-let mortgages and other loans financed largely by external third-party (non-recourse) borrowings. See note C3.3(c) for further details. The Group's exposure is limited to the investment held by the UK with-profits fund, rather than to the individual loans and borrowings themselves. The fair value movements of these loans and borrowings have no effect on shareholders' profit and equity. The most significant non observable inputs to the mortgage fair value are the level of future defaults and prepayments by the mortgage holders.

(ii) Loans of £2,783 million at 31 December 2018 (31 December 2017: £2,512 million), measured as the loan outstanding balance, plus accrued investment income, attached to acquired REALIC business and held to back the liabilities for funds withheld under reinsurance arrangements. The funds withheld liability of £2,941 million at 31 December 2018 (31 December 2017: £2,664 million) is also classified within level 3, accounted for on a fair value basis being equivalent to the carrying value of the underlying assets.

(iii) Excluding the above, the level 3 fair valued financial assets net of financial liabilities are £5,363 million (31 December 2017: £4,499 million). Of this amount, a net liability of £(298) million (31 December 2017: net liability of £(117) million) is internally valued, representing less than 0.1 per cent of the total fair valued financial assets net of financial liabilities (31 December 2017: less than 0.1 per cent). Internal valuations are inherently more subjective than external valuations. Included within these internally valued net asset/liability are:

(a) Debt securities of £582 million (31 December 2017: £500 million), which are either valued on a discounted cash flow method with an internally developed discount rate or on external prices adjusted to reflect the specific known conditions relating to these securities (eg distressed securities or securities which were being restructured).

(b) Private equity and venture investments in both debt and equity securities of £512 million (31 December 2017: £217 million) which are valued internally using discounted cash flows based on management information available for these investments. The significant unobservable inputs include the determination of expected future cash flows on the investments being valued, determination of the probability of counterparty default and prepayments and the selection of appropriate discount rates. The valuation is performed in accordance with International Private Equity and Venture Capital Association Valuation guidelines. These investments are principally held by consolidated investment funds that are managed on behalf of third parties.
(c) Equity release mortgage loan investments of £268 million and a corresponding loan liability backed by these investments of £(354) million (31 December 2017: £302 million loan investments and a corresponding liability of £(385) million) which are valued internally using the discounted cash flow models. The inputs that are significant to the valuation of these investments are primarily the economic assumptions, being the discount rate (risk-free rate plus a liquidity premium) and property values.
(d) Liabilities of £(898) million (31 December 2017: £(403) million) for the net asset value attributable to external unit holders in respect of the consolidated investment funds, which are non-recourse to the Group. These liabilities are valued by reference to the underlying assets.
(e) Derivative liabilities of £(423) million (31 December 2017: £(512) million) which are valued internally using the discounted cash flow method in line with standard market practices but are subject to independent assessment against external counterparties' valuations.
(f) Other sundry individual financial investments of £15 million (31 December 2017: £164 million).

Of the internally valued net liability referred to above of £(298) million (31 December 2017: net liability of £(117) million):

– A net liability of £(53) million (31 December 2017: net asset £67 million) is held by the Group's participating funds and therefore shareholders' profit and equity are not impacted by movements in the valuation of these financial instruments; and
– A net liability of £(245) million (31 December 2017: £(184) million) is held to support non-linked shareholder-backed business. If the value of all the level 3 instruments held to support non-linked shareholder-backed business valued internally decreased by 10 per cent, the change in valuation would be £24 million (31 December 2017: £18 million), which would reduce shareholders' equity by this amount before tax. All this amount passes through the income statement substantially as part of short-term fluctuations in investment returns outside of adjusted IFRS operating profit based on longer-term investment returns.

Other assets at fair value – investment properties
The investment properties of the Group are principally held by the UK and Europe insurance operations that are externally valued by professionally qualified external valuers using the Royal Institution of Chartered Surveyors (RICS) valuation standards. An 'income capitalisation' technique is predominantly applied for these properties. This technique calculates the value through the yield and rental value depending on factors such as the lease length, building quality, covenant and location. The variables used are compared to recent transactions with similar features to those of the Group's investment properties. As the comparisons are not with properties that are virtually identical to the Group's investment properties, adjustments are made by the valuers where appropriate to the variables used. Changes in assumptions relating to these variables could positively or negatively impact the reported fair value of the properties.

(e) Transfers into and transfers out of levels
The Group's policy is to recognise transfers into and transfers out of levels as of the end of each half year reporting period except for material transfers which are recognised as of the date of the event or change in circumstances that caused the transfer. Transfers are deemed to have occurred when there is a material change in the observed valuation inputs or a change in the level of trading activities of the securities.

During the year, the transfers between levels within the Group's portfolio were primarily transfers from level 1 to level 2 of £908 million and transfers from level 2 to level 1 of £976 million. These transfers which relate to equity securities and debt securities arose to reflect the change in the observed valuation inputs and in certain cases, the change in the level of trading activities of the securities.

In addition, the transfers into level 3 during the year were £8 million and the transfers out of level 3 were £30 million. These transfers were primarily between levels 3 and 2 for derivative liabilities.

(f) Valuation processes applied by the Group
The Group's valuation policies, procedures and analyses for instruments categorised as level 3 are overseen by business unit committees as part of the Group's wider financial reporting governance processes. The procedures undertaken include approval of valuation methodologies, verification processes, and resolution of significant or complex valuation issues. In undertaking these activities the Group makes use of the extensive expertise of its asset management functions. In addition, the Group has minimum standards for independent price verification to ensure valuation accuracy is regularly independently verified. Adherence to this policy is monitored across the business units.

C3.2 Debt securities

This note provides analysis of the Group's debt securities, including asset-backed securities and sovereign debt securities.

With the exception of certain debt securities for US insurance operations classified as 'available-for-sale' under IAS 39 as disclosed in notes C3.2(b) to (d) below, the Group's debt securities are carried at fair value through profit or loss.

(a) Credit rating

Debt securities are analysed below according to external credit ratings issued, with equivalent ratings issued by different ratings agencies grouped together. Standard & Poor's ratings have been used where available, if this isn't the case Moody's and then Fitch have been used as alternatives. For the US, NAIC ratings have also been used where relevant. In the table below, AAA is the highest possible rating. Investment grade financial assets are classified within the range of AAA to BBB- ratings. Financial assets which fall outside this range are classified as below BBB-. Debt securities with no external credit rating are classified as 'Other'.

	31 Dec 2018 £m						
	AAA	**AA+ to AA-**	**A+ to A-**	**BBB+ to BBB-**	**Below BBB-**	**Other**	**Total**
Asia							
With-profits	**2,873**	**12,379**	**4,142**	**3,760**	**1,747**	**2,303**	**27,204**
Unit-linked	**817**	**100**	**492**	**1,431**	**426**	**715**	**3,981**
Non-linked shareholder-backed	**1,034**	**3,552**	**3,717**	**2,934**	**2,202**	**1,144**	**14,583**
Asset management	**11**	**-**	**60**	**-**	**-**	**-**	**71**
US							
Non-linked shareholder-backed	**678**	**7,383**	**10,286**	**14,657**	**1,429**	**7,161**	**41,594**
UK and Europe							
With-profits	**6,890**	**9,332**	**11,779**	**14,712**	**2,891**	**8,194**	**53,798**
Unit-linked	**1,041**	**2,459**	**2,215**	**3,501**	**395**	**901**	**10,512**
Non-linked shareholder-backed	**3,007**	**6,413**	**4,651**	**1,515**	**158**	**5,902**	**21,646**
Other operations	**619**	**1,089**	**151**	**41**	**49**	**18**	**1,967**
Total debt securities	**16,970**	**42,707**	**37,493**	**42,551**	**9,297**	**26,338**	**175,356**

	31 Dec 2017 £m						
	AAA	**AA+ to AA-**	**A+ to A-**	**BBB+ to BBB-**	**Below BBB-**	**Other**	**Total**
Asia:							
With-profits	2,504	10,641	3,846	3,234	1,810	2,397	24,432
Unit-linked	528	103	510	1,429	372	565	3,507
Non-linked shareholder-backed	990	2,925	3,226	2,970	1,879	1,053	13,043
US:							
Non-linked shareholder-backed	368	6,352	9,578	12,311	1,000	5,769	35,378
UK and Europe:							
With-profits	6,492	9,378	11,666	12,856	2,877	7,392	50,661
Unit-linked	670	2,732	1,308	1,793	91	117	6,711
Non-linked shareholder-backed	5,118	11,005	9,625	3,267	258	6,062	35,335
Other operations	742	1,264	182	67	36	16	2,307
Total debt securities	17,412	44,400	39,941	37,927	8,323	23,371	171,374

Securities with credit ratings classified as 'Other' can be further analysed as follows:

	31 Dec 2018 £m	**31 Dec 2017 £m**
Asia – non-linked shareholder-backed		
Internally rated:		
Government bonds	**36**	25
Corporate bonds – rated as investment grade by local external ratings agencies	**978**	959
Other	**130**	69
Total Asia non-linked shareholder-backed	**1,144**	1,053

	31 Dec 2018 £m			31 Dec 2017 £m
	Mortgage -backed securities	**Other securities**	**Total**	**Total**
US				
Implicit ratings of other US debt securities based on NAIC* valuations (see below)				
NAIC 1	**2,148**	**2,858**	**5,006**	3,918
NAIC 2	**2**	**2,116**	**2,118**	1,794
NAIC 3-6	**2**	**35**	**37**	57
Total US†	**2,152**	**5,009**	**7,161**	5,769

* The Securities Valuation Office of the NAIC classifies debt securities into six quality categories ranging from Class 1 (the highest) to Class 6 (the lowest). Performing securities are designated as Classes 1 to 5 and securities in or near default are designated Class 6.

† Mortgage-backed securities totalling £1,947 million at 31 December 2018 have credit ratings issued by Standard & Poor's of BBB- or above and hence are designated as investment grade. Other securities totalling £4,974 million at 31 December 2018 with NAIC ratings 1 or 2 are also designated as investment grade.

	31 Dec 2018 £m	31 Dec 2017 £m
UK and Europe		
Internal ratings or unrated		
AAA to A-	**8,150**	7,994
BBB to B-	**3,034**	3,141
Below B- or unrated	**3,813**	2,436
Total UK and Europe	**14,997**	13,571

(b) Additional analysis of US insurance operations debt securities

	31 Dec 2018 £m	31 Dec 2017 £m
Corporate and government security and commercial loans:		
Government	**5,465**	4,835
Publicly traded and SEC Rule 144A securities*	**26,196**	22,849
Non-SEC Rule 144A securities	**6,329**	4,468
Asset-backed securities (see note (e))	**3,604**	3,226
Total US debt securities†	**41,594**	35,378

* A 1990 SEC rule that facilitates the resale of privately placed securities under Rule 144A that are without SEC registration to qualified institutional investors. The rule was designed to develop a more liquid and efficient institutional resale market for unregistered securities.

† Debt securities for US operations included in the statement of financial position comprise:

	31 Dec 2018 £m	31 Dec 2017 £m
Available-for-sale	**40,849**	35,293
Fair value through profit or loss	**745**	85
Total US debt securities	**41,594**	35,378

Realised gains and losses, including impairments, recorded in the income statement are as shown in note B1.2 of this report.

(c) Movements in unrealised gains and losses on Jackson available-for-sale securities

The movement in the statement of financial position value for debt securities classified as available-for-sale was from a net unrealised gain of £1,205 million to a net unrealised loss of £414 million as analysed in the table below.

		Reflected as part of movement in other comprehensive income		
	2018	Foreign exchange translation	Changes in unrealised appreciation†	2017
	£m	£m	£m	£m
Assets fair valued at below book value				
Book value*	**25,330**			6,325
Unrealised gain (loss)	**(925)**	**(43)**	**(776)**	(106)
Fair value (as included in statement of financial position)	**24,405**			6,219
Assets fair valued at or above book value				
Book value*	**15,933**			27,763
Unrealised gain (loss)	**511**	**41**	**(841)**	1,311
Fair value (as included in statement of financial position)	**16,444**			29,074
Total				
Book value*	**41,263**			34,088
Net unrealised gain (loss)	**(414)**	**(2)**	**(1,617)**	1,205
Fair value (as included in the footnote above in the overview table and the statement of financial position)	**40,849**			35,293

* Book value represents cost/amortised cost of the debt securities.

† Translated at the average rate of US$1.3352:£1.00.

(d) US debt securities classified as available-for-sale in an unrealised loss position

(i) Fair value of securities as a percentage of book value

The fair value of the debt securities in a gross unrealised loss position for various percentages of book value:

	31 Dec 2018 £m		31 Dec 2017 £m	
	Fair value	Unrealised loss	Fair value	Unrealised loss
Between 90% and 100%	**23,662**	**(809)**	6,170	(95)
Between 80% and 90%	**707**	**(104)**	36	(6)
Below 80%:				
Other asset-backed securities	**–**	**–**	10	(4)
Corporate bonds	**36**	**(12)**	3	(1)
	36	**(12)**	13	(5)
Total	**24,405**	**(925)**	6,219	(106)

(ii) Unrealised losses by maturity of security

	31 Dec 2018 £m	31 Dec 2017 £m
1 year to 5 years	**(72)**	(7)
5 years to 10 years	**(436)**	(41)
More than 10 years	**(372)**	(39)
Mortgage-backed and other debt securities	**(45)**	(19)
Total	**(925)**	(106)

(iii) Age analysis of unrealised losses for the periods indicated

The age analysis of all the unrealised losses in the portfolio by reference to the length of time the securities have been in an unrealised loss position:

	31 Dec 2018 £m			31 Dec 2017 £m		
	Non-investment grade	Investment grade	Total	Non-investment grade	Investment grade	Total
Less than 6 months	**(20)**	**(141)**	**(161)**	(4)	(31)	(35)
6 months to 1 year	**(22)**	**(440)**	**(462)**	(1)	(4)	(5)
1 year to 2 years	**(10)**	**(142)**	**(152)**	–	(49)	(49)
2 years to 3 years	**–**	**(123)**	**(123)**	(1)	(6)	(7)
More than 3 years	**(2)**	**(25)**	**(27)**	–	(10)	(10)
Total	**(54)**	**(871)**	**(925)**	(6)	(100)	(106)

The age analysis as at 31 December, of the securities whose fair values were below 80 per cent of the book value:

	31 Dec 2018 £m		31 Dec 2017 £m	
Age analysis	**Fair value**	**Unrealised loss**	**Fair value**	**Unrealised loss**
Less than 3 months	**32**	**(10)**	2	–
3 months to 6 months	**2**	**(1)**	1	(1)
More than 6 months	**2**	**(1)**	10	(4)
Total	**36**	**(12)**	13	(5)

(e) Asset-backed securities

The Group's holdings in Asset-Backed Securities (ABS), which comprise Residential Mortgage-Backed Securities (RMBS), Commercial Mortgage-Backed Securities (CMBS), Collateralised Debt Obligations (CDO) funds and other asset-backed securities are as follows:

	31 Dec 2018 £m	31 Dec 2017 £m
Shareholder-backed business		
Asia operations[note (i)]	**121**	118
US operations[note (ii)]	**3,604**	3,226
UK and Europe operations (2018: 42% AAA, 13% AA)[note (iii)]	**1,406**	1,070
Other operations[note (iv)]	**445**	589
	5,576	5,003
With-profits business		
Asia operations[note (i)]	**235**	233
UK and Europe operations (2018: 66% AAA, 12% AA)[note (iii)]	**5,270**	5,658
	5,505	5,891
Total	**11,081**	10,894

Notes

(i) Asia operations

The Asia operations' exposure to asset-backed securities is primarily held by the with-profits businesses. Of the £235 million (31 December 2017: £233 million), 99.8 per cent (2017: 98.2 per cent) are investment grade.

(ii) US operations

US operations' exposure to asset-backed securities at 31 December comprises:

	31 Dec 2018 £m	31 Dec 2017 £m
RMBS		
Sub-prime (2018: 1% AAA, 6% AA, 2% A)	**96**	112
Alt-A (2018: 3% AAA, 42% A)	**105**	126
Prime including agency (2018: 14% AAA, 62% AA, 10% A)	**441**	440
CMBS (2018: 80% AAA, 15% AA, 2% A)	**1,945**	1,579
CDO funds (2018: 13% AA, 24% A), including £nil exposure to sub-prime	**13**	28
Other ABS (2018: 20% AAA, 14% AA, 49% A), including £77 million exposure to sub-prime	**1,004**	941
Total	**3,604**	3,226

(iii) UK and Europe operations

The majority of holdings of the shareholder-backed business are UK securities and relate to PAC's annuity business. Of the holdings of the with-profits businesses, £1,823 million (31 December 2017: £1,913 million) relates to exposure to the US markets with the remaining exposure being primarily to the UK market.

(iv) Other operations

Other operations' exposure to asset-backed securities is held by Prudential Capital with no sub-prime exposure. Of the £445 million, 99 per cent (31 December 2017: 96 per cent) are graded AAA.

(f) Group sovereign debt and bank debt exposure

The Group exposures held by the shareholder-backed business and with-profits funds in sovereign debts and bank debt securities are analysed as follows:

Exposure to sovereign debts

	31 Dec 2018 £m		31 Dec 2017 £m	
	Shareholder-backed business	**With-profits funds**	**Shareholder-backed business**	**With-profits funds**
Italy	**–**	**57**	58	63
Spain	**36**	**18**	34	18
France	**–**	**50**	23	38
Germany*	**239**	**281**	693	301
Other Eurozone	**103**	**34**	82	31
Total Eurozone	**378**	**440**	890	451
United Kingdom	**3,226**	**3,013**	5,918	3,287
United States†	**5,647**	**11,858**	5,078	10,156
Other, including Asia	**5,142**	**2,745**	4,638	2,143
Total	**14,393**	**18,056**	16,524	16,037

* Including bonds guaranteed by the federal government.

† The exposure to the United States sovereign debt comprises holdings of the US, the UK and Europe and Asia insurance operations.

Exposure to bank debt securities

	31 Dec 2018 £m							31 Dec 2017 £m
	Senior debt			Subordinated debt				
Shareholder-backed business	**Covered**	**Senior**	**Total**	**Tier 1**	**Tier 2**	**Total**	**Total**	**Total**
Spain	**42**	**64**	**106**	**–**	**–**	**–**	**106**	68
France	**20**	**119**	**139**	**14**	**3**	**17**	**156**	86
Germany	**30**	**–**	**30**	**6**	**89**	**95**	**125**	117
Netherlands	**–**	**69**	**69**	**3**	**1**	**4**	**73**	71
Other Eurozone	**15**	**2**	**17**	**–**	**–**	**–**	**17**	15
Total Eurozone	**107**	**254**	**361**	**23**	**93**	**116**	**477**	357
United Kingdom	**550**	**623**	**1,173**	**9**	**164**	**173**	**1,346**	1,382
United States	**–**	**2,614**	**2,614**	**1**	**52**	**53**	**2,667**	2,619
Other, including Asia	**–**	**759**	**759**	**109**	**369**	**478**	**1,237**	1,163
Total	**657**	**4,250**	**4,907**	**142**	**678**	**820**	**5,727**	5,521
With-profits funds								
Italy	**–**	**38**	**38**	**–**	**–**	**–**	**38**	31
Spain	**–**	**17**	**17**	**–**	**–**	**–**	**17**	16
France	**6**	**250**	**256**	**1**	**95**	**96**	**352**	286
Germany	**140**	**46**	**186**	**14**	**29**	**43**	**229**	180
Netherlands	**–**	**253**	**253**	**12**	**1**	**13**	**266**	199
Other Eurozone	**–**	**74**	**74**	**–**	**–**	**–**	**74**	27
Total Eurozone	**146**	**678**	**824**	**27**	**125**	**152**	**976**	739
United Kingdom	**909**	**850**	**1,759**	**2**	**433**	**435**	**2,194**	1,938
United States	**–**	**2,418**	**2,418**	**1**	**311**	**312**	**2,730**	2,518
Other, including Asia	**575**	**1,459**	**2,034**	**339**	**452**	**791**	**2,825**	2,531
Total	**1,630**	**5,405**	**7,035**	**369**	**1,321**	**1,690**	**8,725**	7,726

The tables above exclude assets held to cover linked liabilities and those of the consolidated unit trusts and similar funds. In addition, the tables above exclude the proportionate share of sovereign debt holdings of the Group's joint venture operations.

C3.3 Loans portfolio

(a) Overview of loans portfolio

Loans are accounted for at amortised cost net of impairment except for:

– Certain mortgage loans which have been designated at fair value through profit or loss of the UK and Europe insurance operations as this loan portfolio is managed and evaluated on a fair value basis; and
– Certain policy loans of the US insurance operations that are held to back liabilities for funds withheld under reinsurance arrangements and are also accounted on a fair value basis.

The amounts included in the statement of financial position are analysed as follows:

	31 Dec 2018 £m				**31 Dec 2017 £m**			
	Mortgage loans*	**Policy loans†**	**Other loans‡**	**Total**	**Mortgage loans***	**Policy loans†**	**Other loans‡**	**Total**
Asia								
With-profits	**–**	**727**	**65**	**792**	–	613	112	725
Non-linked shareholder-backed	**156**	**226**	**203**	**585**	177	216	199	592
US								
Non-linked shareholder-backed	**7,385**	**3,681**	**–**	**11,066**	6,236	3,394	–	9,630
UK and Europe								
With-profits	**2,461**	**3**	**1,389**	**3,853**	2,441	4	1,823	4,268
Non-linked shareholder-backed	**1,655**	**–**	**59**	**1,714**	1,681	–	37	1,718
Other operations	**–**	**–**	**–**	**–**	–	–	109	109
Total loans securities	**11,657**	**4,637**	**1,716**	**18,010**	10,535	4,227	2,280	17,042

* All mortgage loans are secured by properties.

† In the US £2,783 million (31 December 2017: £2,512 million) policy loans are backing liabilities for funds withheld under reinsurance arrangements and are accounted for at fair value through profit or loss. All other policy loans are accounted for at amortised cost, less any impairment.

‡ Other loans held in UK with-profits funds are commercial loans and comprise mainly syndicated loans.

(b) Additional information on US mortgage loans

In the US, mortgage loans are all commercial mortgage loans that are secured by the following property types: industrial, multi-family residential, suburban office, retail or hotel. The average loan size is £14.0 million (2017: £12.6 million). The portfolio has a current estimated average loan to value of 53 per cent (2017: 55 per cent).

Jackson had no mortgage loans where the contractual terms of the agreements had been restructured at the end of both 2018 and 2017.

(c) Additional information on UK mortgage loans

The UK with-profits fund invests in an entity that holds a portfolio of buy-to-let mortgage loans. The vehicle financed its acquisitions through the issue of debt instruments, largely to external parties, securitised upon the loans acquired. These third-party borrowings have no recourse to any other assets of the Group and the Group’s exposure is limited to the amount invested by the UK with-profits fund.

By carrying value, £1,237 million of the £1,655 million (31 December 2017: £1,267 million of £1,681 million) mortgage loans held by the UK shareholder-backed business relates to lifetime (equity release) mortgage business which has an average loan to property value of 33 per cent (31 December 2017: 31 per cent).

C4 Policyholder liabilities and unallocated surplus

The note provides information of policyholder liabilities and unallocated surplus of with-profits funds held on the Group's statement of financial position:

C4.1 Movement and duration of liabilities

C4.1(a) Group overview

(i) Analysis of movements in policyholder liabilities and unallocated surplus of with-profits funds

	Asia £m note C4.1(b)	US £m note C4.1(c)	UK and Europe £m note C4.1(d)	Total £m
At 1 January 2017	62,784	177,626	169,304	409,714
Comprising:				
– Policyholder liabilities on the consolidated statement of financial position note (i)	53,716	177,626	157,654	388,996
– Unallocated surplus of with-profits funds on the consolidated statement of financial position	2,667	–	11,650	14,317
– Group's share of policyholder liabilities of joint ventures and associate note (ii)	6,401	–	–	6,401
Premiums	11,863	15,219	14,810	41,892
Surrenders	(3,079)	(10,017)	(6,939)	(20,035)
Maturities/deaths	(1,909)	(2,065)	(7,135)	(11,109)
Net flows	6,875	3,137	736	10,748
Shareholders' transfers post-tax	(54)	–	(233)	(287)
Investment-related items and other movements	8,182	16,251	11,146	35,579
Foreign exchange translation differences	(3,948)	(16,290)	113	(20,125)
At 31 December 2017/1 January 2018	**73,839**	**180,724**	**181,066**	**435,629**
Comprising:				
– Policyholder liabilities on the consolidated statement of financial position note (i) *(excludes £32 million classified as unallocated to a segment)*	**62,898**	**180,724**	**167,589**	**411,211**
– Unallocated surplus of with-profits funds on the consolidated statement of financial position	**3,474**	**–**	**13,477**	**16,951**
– Group's share of policyholder liabilities of joint ventures and associate note (ii)	**7,467**	**–**	**–**	**7,467**
Reclassification of reinsured UK annuity contracts as held for sale note (iii)	**–**	**–**	**(10,858)**	**(10,858)**
Premiums	**13,187**	**13,940**	**14,011**	**41,138**
Surrenders	**(2,793)**	**(12,141)**	**(6,780)**	**(21,714)**
Maturities/deaths	**(1,978)**	**(2,012)**	**(6,796)**	**(10,786)**
Net flows	**8,416**	**(213)**	**435**	**8,638**
Addition for closed block of group payout annuities in the US note (iv)	**–**	**4,143**	**–**	**4,143**
Shareholders' transfers post-tax	**(65)**	**–**	**(259)**	**(324)**
Investment-related items and other movements	**(2,784)**	**(9,999)**	**(5,481)**	**(18,264)**
Foreign exchange translation differences	**3,357**	**10,945**	**(14)**	**14,288**
At 31 December 2018	**82,763**	**185,600**	**164,889**	**433,252**
Comprising:				
– Policyholder liabilities on the consolidated statement of financial position note (i) *(excludes £39 million classified as unallocated to a segment)*	**72,107**	**185,600**	**151,555**	**409,262**
– Unallocated surplus of with-profits funds on the consolidated statement of financial position	**2,511**	**–**	**13,334**	**15,845**
– Group's share of policyholder liabilities of joint ventures and associate note (ii)	**8,145**	**–**	**–**	**8,145**
Average policyholder liability balances note (v)				
2018	**75,309**	**182,126**	**162,287**	**419,722**
2017	65,241	179,175	162,622	407,038

Notes

(i) The policyholder liabilities of the Asia insurance operations of £72,107 million (31 December 2017: £62,898 million), shown in the table above, is after deducting the intra-group reinsurance liabilities ceded by the UK and Europe insurance operations of £1,109 million (31 December 2017: £1,235 million) to the Hong Kong with-profits business. Including this amount total Asia policyholder liabilities are £73,216 million (31 December 2017: £64,133 million).

(ii) The Group's investments in joint ventures and associate are accounted for on an equity method basis in the Group's balance sheet. The Group's share of the policyholder liabilities as shown above relate to life businesses in China, India and of the Takaful business in Malaysia.

(iii) The reclassification as held for sale of the reinsured UK annuity business that will be transferred to Rothesay life once the Part VII process is complete reflects the value of policyholder liabilities held at 1 January 2018.

(iv) In October 2018, Jackson entered into an agreement with John Hancock Life to reinsure 100 per cent of the group payout annuity business. The transaction resulted in an increase to policyholder liabilities of Jackson £4.1 billion at the inception of the contract.

(v) Averages have been based on opening and closing balances and adjusted for acquisitions, disposals and corporate transactions arising in the year and exclude unallocated surplus of with-profits funds.

The items above represent the amount attributable to changes in policyholder liabilities and unallocated surplus of with-profits funds as a result of each of the components listed. The policyholder liabilities shown include investment contracts without discretionary participation features (as defined in IFRS 4) and their full movement in the year but exclude liabilities that have not been allocated to a reporting segment. The items above are shown gross of external reinsurance.

The analysis includes the impact of premiums, claims and investment movements on policyholders' liabilities. The impact does not represent premiums, claims and investment movements as reported in the income statement. For example, the premiums shown above will exclude any deductions for fees/charges. Claims (surrenders, maturities and deaths) represent the policyholder liabilities provision released rather than the claim amount paid to the policyholder.

(ii) Analysis of movements in policyholder liabilities for shareholder-backed business

	Asia £m	**US £m**	**UK and Europe £m**	**Total £m**
At 1 January 2017	32,851	177,626	56,158	266,635
Premiums	6,064	15,219	2,283	23,566
Surrenders	(2,755)	(10,017)	(2,433)	(15,205)
Maturities/deaths	(1,008)	(2,065)	(2,571)	(5,644)
Net flows[note (i)]	2,301	3,137	(2,721)	2,717
Investment-related items and other movements	3,797	16,251	2,930	22,978
Foreign exchange translation differences	(1,547)	(16,290)	–	(17,837)
At 31 December 2017/1 January 2018	**37,402**	**180,724**	**56,367**	**274,493**
Comprising:				
- Policyholder liabilities on the consolidated statement of financial position (excludes £32 million classified as unallocated to a segment)	**29,935**	**180,724**	**56,367**	**267,026**
- Group's share of policyholder liabilities relating to joint ventures and associate	**7,467**	**–**	**–**	**7,467**
Reclassification of reinsured UK annuity contracts as held for sale[note (ii)]	**–**	**–**	**(10,858)**	**(10,858)**
Premiums	**6,752**	**13,940**	**1,486**	**22,178**
Surrenders	**(2,455)**	**(12,141)**	**(2,016)**	**(16,612)**
Maturities/deaths	**(1,046)**	**(2,012)**	**(2,244)**	**(5,302)**
Net flows[note (i)]	**3,251**	**(213)**	**(2,774)**	**264**
Addition for closed block of group payout annuities in the US[note (iii)]	**–**	**4,143**	**–**	**4,143**
Investment-related items and other movements	**(1,204)**	**(9,999)**	**(1,975)**	**(13,178)**
Foreign exchange translation differences	**1,148**	**10,945**	**–**	**12,093**
At 31 December 2018	**40,597**	**185,600**	**40,760**	**266,957**
Comprising:				
- Policyholder liabilities on the consolidated statement of financial position (excludes £39 million classified as unallocated to a segment)	**32,452**	**185,600**	**40,760**	**258,812**
- Group's share of policyholder liabilities relating to joint ventures and associate	**8,145**	**–**	**–**	**8,145**

Notes

(i) Including net flows of the Group's insurance joint ventures and associate.

(ii) The reclassification as held for sale of the reinsured UK annuity business that will be transferred to Rothesay life once the Part VII process is complete reflects those policyholder liabilities held at 1 January 2018.

(iii) In October 2018, Jackson entered into an agreement with John Hancock Life to reinsure 100 per cent of the group payout annuity business. The transaction resulted in an increase to policyholder liabilities of Jackson £4.1 billion at the inception of the contract.

C4.1(b) Asia insurance operations

(i) Analysis of movements in policyholder liabilities and unallocated surplus of with-profits funds

A reconciliation of the total policyholder liabilities and unallocated surplus of with-profits funds of Asia insurance operations from the beginning of the year to the end of the year is as follows:

	With-profits business £m note (vi)	Unit-linked liabilities £m	Other business £m	Total £m
At 1 January 2017	29,933	17,507	15,344	62,784
Comprising:				
– Policyholder liabilities on the consolidated statement of financial position	27,266	14,289	12,161	53,716
– Unallocated surplus of with-profits funds on the consolidated statement of financial position	2,667	-	-	2,667
*– Group's share of policyholder liabilities relating to joint ventures and associate*note (i)	-	3,218	3,183	6,401
Premiums				
New business	1,143	1,298	999	3,440
In-force	4,656	1,637	2,130	8,423
	5,799	2,935	3,129	11,863
Surrenders note (ii)	(324)	(2,288)	(467)	(3,079)
Maturities/deaths	(901)	(150)	(858)	(1,909)
Net flowsnote (iii)	4,574	497	1,804	6,875
Shareholders' transfers post-tax	(54)	–	–	(54)
Investment-related items and other movements	4,385	2,830	967	8,182
Foreign exchange translation differencesnote (v)	(2,401)	(807)	(740)	(3,948)
At 31 December 2017/1 January 2018	**36,437**	**20,027**	**17,375**	**73,839**
Comprising:				
– Policyholder liabilities on the consolidated statement of financial position	**32,963**	**16,263**	**13,672**	**62,898**
– Unallocated surplus of with-profits funds on the consolidated statement of financial position	**3,474**	**–**	**–**	**3,474**
*– Group's share of policyholder liabilities relating to joint ventures and associate*note (i)	**–**	**3,764**	**3,703**	**7,467**
Premiums				
New business	**1,155**	**1,426**	**1,085**	**3,666**
In-force	**5,280**	**1,767**	**2,474**	**9,521**
	6,435	**3,193**	**3,559**	**13,187**
Surrenders note (ii)	**(338)**	**(1,904)**	**(551)**	**(2,793)**
Maturities/deaths	**(932)**	**(140)**	**(906)**	**(1,978)**
Net flowsnote (iii)	**5,165**	**1,149**	**2,102**	**8,416**
Shareholders' transfers post-tax	**(65)**	**–**	**–**	**(65)**
Investment-related items and other movementsnote (iv)	**(1,580)**	**(1,425)**	**221**	**(2,784)**
Foreign exchange translation differencesnote (v)	**2,209**	**431**	**717**	**3,357**
At 31 December 2018	**42,166**	**20,182**	**20,415**	**82,763**
Comprising:				
– Policyholder liabilities on the consolidated statement of financial position	**39,655**	**16,368**	**16,084**	**72,107**
– Unallocated surplus of with-profits funds on the consolidated statement of financial position	**2,511**	**–**	**–**	**2,511**
*– Group's share of policyholder liabilities relating to joint ventures and associate*note (i)	**–**	**3,814**	**4,331**	**8,145**
Average policyholder liability balancesnote (vii)				
2018	**36,309**	**20,105**	**18,895**	**75,309**
2017	30,115	18,767	16,359	65,241

Notes

(i) The Group's investment in joint ventures are accounted for on an equity method and the Group's share of the policyholder liabilities as shown above relate to the life business in China, India and of the Takaful business in Malaysia.

(ii) The rate of surrenders for shareholder-backed business (expressed as a percentage of opening liabilities) was 6.6 per cent in 2018 (2017: 8.4 per cent).

(iii) Net flows have increased by £1,541 million to £8,416 million in 2018 predominantly reflecting continued growth of the in-force book.

(iv) Investment-related items and other movements for 2018 primarily represent unrealised investments losses following unfavourable equity markets in the year and rising interest rates.

(v) Movements in the year have been translated at the average exchange rates for the year. The closing balance has been translated at the closing spot rates as at the end of the year. Differences upon retranslation are included in foreign exchange translation differences.

(vi) The policyholder liabilities of the with-profits business of £39,655 million, shown in the table above, is after deducting the intra-group reinsurance liabilities ceded by the UK and Europe insurance operations of £1,109 million to the Hong Kong with-profits business (31 December 2017: £1,235 million). Including this amount the Asia with-profits policyholder liabilities are £40,764 million (31 December 2017: £34,198 million).

(vii) Averages have been based on opening and closing balances and exclude unallocated surplus of with-profits funds.

(ii) Duration of liabilities

The table below shows the carrying value of policyholder liabilities and the maturity profile of the cash flows on a discounted basis, taking account of expected future premiums and investment returns:

	31 Dec 2018 £m	**31 Dec 2017 £m**
Policyholder liabilities	**72,107**	62,898

Expected maturity:	**31 Dec 2018 %**	**31 Dec 2017 %**
0 to 5 years	**20**	21
5 to 10 years	**19**	19
10 to 15 years	**15**	16
15 to 20 years	**12**	12
20 to 25 years	**10**	10
Over 25 years	**24**	22

C4.1(c) US insurance operations

(i) Analysis of movements in policyholder liabilities

A reconciliation of the total policyholder liabilities of US insurance operations from the beginning of the year to the end of the year is as follows:

US insurance operations

	Variable annuity separate account liabilities £m	Fixed annuity, GICs and other business £m	Total £m
At 1 January 2017	120,411	57,215	177,626
Premiums	11,529	3,690	15,219
Surrenders	(6,997)	(3,020)	(10,017)
Maturities/deaths	(1,026)	(1,039)	(2,065)
Net flows note (ii)	3,506	(369)	3,137
Transfers from general to separate account	2,096	(2,096)	–
Investment-related items and other movements	15,956	295	16,251
Foreign exchange translation differences note (i)	(11,441)	(4,849)	(16,290)
At 31 December 2017/1 January 2018	**130,528**	**50,196**	**180,724**
Premiums	**10,969**	**2,971**	**13,940**
Surrenders	**(8,797)**	**(3,344)**	**(12,141)**
Maturities/deaths	**(1,085)**	**(927)**	**(2,012)**
Net flows note (ii)	**1,087**	**(1,300)**	**(213)**
Addition for closed block of group payout annuities in the US note (iii)	**–**	**4,143**	**4,143**
Transfers from general to separate account	**530**	**(530)**	**–**
Investment-related items and other movements note (iv)	**(11,561)**	**1,562**	**(9,999)**
Foreign exchange translation differences note (i)	**7,636**	**3,309**	**10,945**
At 31 December 2018	**128,220**	**57,380**	**185,600**
Average policyholder liability balances note (v)			
2018	**129,374**	**52,752**	**182,126**
2017	125,469	53,706	179,175

Notes

(i) Movements in the year have been translated at an average rate of US$1.34: £1.00 (2017: US$1.29: £1.00). The closing balances have been translated at closing rate of US$1.27: £1.00 (2017: US$1.35: £1.00). Differences upon retranslation are included in foreign exchange translation differences.

(ii) Net outflows were £213 million (2017: inflows £3,137 million), with positive inflows to variable annuities business as new business exceeds withdrawals and surrenders offset by outflows from fixed annuity, GICs and other business as the portfolio matures.

(iii) In October 2018, Jackson entered into an agreement with John Hancock Life to reinsure 100 per cent of the group payout annuity business. The transaction resulted in an increase to policyholder liabilities of Jackson £4.1 billion at the inception of the contract.

(iv) Negative investment-related items and other movements in variable annuity separate account liabilities of £(11,561) million for 2018 primarily reflects the decrease in equity and bond values during the year. Fixed annuity, GIC and other business investment and other movements of £1,562 million primarily reflect the interest credited to the policyholder accounts and increase in the guarantee reserves in the year.

(v) Averages have been based on opening and closing balances and adjusted for acquisitions, disposals and corporate transactions arising in the year.

(ii) Duration of liabilities

The table below shows the carrying value of policyholder liabilities and maturity profile of the cash flows on a discounted basis for 2018 and 2017:

	31 Dec 2018			31 Dec 2017		
	Fixed annuity and other business (including GICs and similar contracts) £m	Variable annuity separate account liabilities £m	Total £m	Fixed annuity and other business (including GICs and similar contracts) £m	Variable annuity separate account liabilities £m	Total £m
Policyholder liabilities	**57,380**	**128,220**	**185,600**	50,196	130,528	180,724
Expected maturity:	**%**	**%**	**%**	%	%	%
0 to 5 years	**51**	**40**	**43**	50	42	44
5 to 10 years	**24**	**28**	**27**	25	29	28
10 to 15 years	**12**	**16**	**15**	12	15	14
15 to 20 years	**7**	**9**	**8**	7	8	8
20 to 25 years	**3**	**4**	**4**	3	4	4
Over 25 years	**3**	**3**	**3**	3	2	2

C4.1(d) UK and Europe insurance operations

(i) Analysis of movements in policyholder liabilities and unallocated surplus of with-profits funds

A reconciliation of the total policyholder liabilities and unallocated surplus of with-profits funds of UK and Europe insurance operations from the beginning of the year to the end of the year is as follows:

		Shareholder-backed funds and subsidiaries		
	With-profits sub-funds £m note (v)	**Unit-linked liabilities £m**	**Annuity and other long-term business £m**	**Total £m**
At 1 January 2017	113,146	22,119	34,039	169,304
Comprising:				
– Policyholder liabilities on the consolidated statement of financial position	101,496	22,119	34,039	157,654
– Unallocated surplus of with-profits funds on the consolidated statement of financial position	11,650	–	–	11,650
Premiums	12,527	1,923	360	14,810
Surrenders	(4,506)	(2,342)	(91)	(6,939)
Maturities/deaths	(4,564)	(612)	(1,959)	(7,135)
Net flows note (i)	3,457	(1,031)	(1,690)	736
Shareholders' transfers post-tax	(233)	–	–	(233)
Switches	(192)	192	–	–
Investment-related items and other movements	8,408	1,865	873	11,146
Foreign exchange translation differences	113	–	–	113
At 31 December 2017/1 January 2018	**124,699**	**23,145**	**33,222**	**181,066**
Comprising:				
– Policyholder liabilities on the consolidated statement of financial position	**111,222**	**23,145**	**33,222**	**167,589**
– Unallocated surplus of with-profits funds on the consolidated statement of financial position	**13,477**	**–**	**–**	**13,477**
Reclassification of reinsured UK annuity contracts as held for sale note (ii)	**–**	**–**	**(10,858)**	**(10,858)**
Premiums	**12,525**	**1,147**	**339**	**14,011**
Surrenders	**(4,764)**	**(1,950)**	**(66)**	**(6,780)**
Maturities/deaths	**(4,552)**	**(619)**	**(1,625)**	**(6,796)**
Net flows note (i)	**3,209**	**(1,422)**	**(1,352)**	**435**
Shareholders' transfers post-tax	**(259)**	**–**	**–**	**(259)**
Switches	**(165)**	**165**	**–**	**–**
Investment-related items and other movements note (iii)	**(3,341)**	**(1,171)**	**(969)**	**(5,481)**
Foreign exchange translation differences	**(14)**	**–**	**–**	**(14)**
At 31 December 2018	**124,129**	**20,717**	**20,043**	**164,889**
Comprising:				
– Policyholder liabilities on the consolidated statement of financial position	**110,795**	**20,717**	**20,043**	**151,555**
– Unallocated surplus of with-profits funds on the consolidated statement of financial position	**13,334**	**–**	**–**	**13,334**
Average policyholder liability balances note (iv)				
2018	**111,009**	**21,931**	**29,347**	**162,287**
2017	106,359	22,632	33,631	162,622

Notes

(i) Net inflows were £435 million (31 December 2017: net inflows of £736 million). Inflows into the with-profits business were offset by outflows from both the annuity business, as the closed book matures, and the unit-linked business. The levels of inflows/outflows for the unit-linked business is driven by corporate pension schemes with transfers in or out from only a small number of schemes influencing the level of flows in the year.

(ii) The reclassification as held for sale of the reinsured UK annuity business that will be transferred to Rothesay life once the Part VII process is complete reflects the value policyholder liabilities held at 1 January 2018.

(iii) Investment-related items and other movements for with-profits business principally comprise investment return attributable to policyholders reflecting falling equity markets in the later quarter of the year. For shareholder-backed annuity and other long-term business, investment-related items and other movements include the effect of movements in interest rates and credit spreads.

(iv) Averages have been based on opening and closing balances and adjusted for acquisitions, disposals and corporate transactions arising in the year and exclude unallocated surplus of with-profits funds.

(v) Includes the Scottish Amicable Insurance Fund.

(ii) Duration of liabilities

The following tables show the carrying value of the policyholder liabilities and the maturity profile of the cash flows, on a discounted basis:

	31 Dec 2018 £m									
	With-profits business			Annuity business (insurance contracts)			Other			Total
	Insurance contracts	Investment contracts	Total	Non-profit annuities within WPSF	Shareholder-backed annuity	Total	Insurance contracts	Investments contracts	Total	
Policyholder liabilities	**34,242**	**67,020**	**101,262**	**9,533**	**19,119**	**28,652**	**6,063**	**15,578**	**21,641**	**151,555**
	31 Dec 2018 %									
Expected maturity:										
0 to 5 years	**34**	**37**	**36**	**33**	**27**	**29**	**44**	**32**	**36**	**35**
5 to 10 years	**23**	**27**	**26**	**26**	**23**	**24**	**25**	**24**	**24**	**25**
10 to 15 years	**16**	**17**	**17**	**17**	**19**	**18**	**15**	**18**	**17**	**17**
15 to 20 years	**11**	**9**	**10**	**11**	**14**	**13**	**8**	**12**	**11**	**10**
20 to 25 years	**7**	**4**	**5**	**6**	**9**	**8**	**4**	**7**	**6**	**6**
over 25 years	**9**	**6**	**6**	**7**	**8**	**8**	**4**	**7**	**6**	**7**
	31 Dec 2017 £m									
Policyholder liabilities	38,285	62,328	100,613	10,609	32,572	43,181	6,714	17,081	23,795	167,589
	31 Dec 2017 %									
Expected maturity:										
0 to 5 years	33	37	36	31	26	27	41	31	34	34
5 to 10 years	23	27	25	24	23	23	26	22	23	25
10 to 15 years	16	17	17	17	18	18	15	18	17	17
15 to 20 years	11	10	10	11	13	13	9	13	12	11
20 to 25 years	7	4	5	7	9	9	5	8	7	6
over 25 years	10	5	7	10	11	10	4	8	7	7

- The cash flow projections of expected benefit payments used in the maturity profile table above are from value of in-force business and exclude the value of future new business, including future vesting of internal pension contracts.
- Benefit payments do not reflect the pattern of bonuses and shareholder transfers in respect of the with-profits business.
- Shareholder-backed annuity business includes the ex-PRIL and the legacy PAC shareholder annuity business but excludes the amount classified as held for sale.
- Investment contracts under 'Other' comprise certain unit-linked and similar contracts accounted for under IAS 39 and IFRS 15.
- For business with no maturity term included within the contracts, for example, with-profits investment bonds such as Prudence Bonds, an assumption is made as to likely duration based on prior experience.

C5 Intangible assets

C5.1 Goodwill

	31 Dec 2018 £m			31 Dec 2017 £m
	Attributable to:			
	Shareholders	With-profits	Total	Total
Carrying value at beginning of year	**1,458**	**24**	**1,482**	1,628
Acquisition of TMB Asset Management Co., Ltd. in Thailand (see note D1.2)	**181**	**–**	**181**	–
Other additions in the year (see below)	**–**	**195**	**195**	9
Disposals/reclassifications to held for sale	**–**	**(10)**	**(10)**	(155)
Exchange differences	**12**	**(3)**	**9**	–
Carrying value at end of year	**1,651**	**206**	**1,857**	1,482
Comprising:				
M&G – attributable to shareholders			**1,153**	1,153
Other – attributable to shareholders			**498**	305
Goodwill – attributable to shareholders			**1,651**	1,458
Venture fund investments – attributable to with-profits funds			**206**	24
			1,857	1,482

During 2018, the UK with-profits fund, via its venture fund holdings managed by M&GPrudential asset management, made a small number of acquisitions that are consolidated by the Group resulting in an addition to goodwill of £195 million. As these transactions are within the with-profits fund, they have no impact on shareholders' profit or equity for the year ended 31 December 2018. The impact on the Group's consolidated revenue, including investment returns, is not material. Had the acquisitions been effected at 1 January 2018, the revenue and profit of the Group for 2018 would not have been materially different.

C5.2 Deferred acquisition costs and other intangible assets

	31 Dec 2018 £m	31 Dec 2017 £m
Deferred acquisition costs and other intangible assets attributable to shareholders	**11,784**	10,866
Other intangible assets, including computer software, attributable to with-profits funds	**139**	145
Total of deferred acquisition costs and other intangible assets	**11,923**	11,011

Total deferred acquisition costs and other intangible assets attributable to shareholders comprise:

	31 Dec 2018 £m	31 Dec 2017 £m
Deferred acquisition costs related to insurance contracts as classified under IFRS 4	**10,017**	9,170
Deferred acquisition costs related to investment management contracts, including life assurance contracts classified as financial instruments and investment management contracts under IFRS 4	**78**	63
Deferred acquisition costs related to insurance and investment contracts	**10,095**	9,233
Present value of acquired in-force policies for insurance contracts as classified under IFRS 4 (PVIF)	**34**	36
Distribution rights and other intangibles	**1,655**	1,597
Present value of acquired in-force (PVIF) and other intangibles attributable to shareholders	**1,689**	1,633
Total of deferred acquisition costs and other intangible assets[note (a)]	**11,784**	10,866

Notes

(a) Total deferred acquisition costs and other intangible assets can be further analysed by business operations as follows:

	31 Dec 2018 £m						31 Dec 2017 £m
	Deferred acquisition costs						
	Asia insurance	US insurance note (b)	UK and Europe insurance	All asset management	PVIF and other intangibles*	Total	Total
Balance at 1 January	**946**	**8,197**	**84**	**6**	**1,633**	**10,866**	10,755
Additions	**419**	**569**	**15**	**15**	**230**	**1,248**	1,240
Amortisation to the income statement:[note (c)†]							
Adjusted IFRS operating profit based on longer-term investment returns	**(148)**	**(683)**	**(11)**	**(3)**	**(179)**	**(1,024)**	(709)
Non-operating profit	**–**	**(114)**	**–**	**–**	**(4)**	**(118)**	455
	(148)	**(797)**	**(11)**	**(3)**	**(183)**	**(1,142)**	(254)
Disposals and transfers	**–**	**–**	**–**	**–**	**(14)**	**(14)**	–
Exchange differences and other movements	**47**	**512**	**(2)**	**–**	**23**	**580**	(799)
Amortisation of DAC related to net unrealised valuation movements on the US insurance operation's available-for-sale securities recognised within other comprehensive income[†]	**–**	**246**	**–**	**–**	**–**	**246**	(76)
Balance at 31 December	**1,264**	**8,727**	**86**	**18**	**1,689**	**11,784**	10,866

* PVIF and other intangibles comprise PVIF, distribution rights and other intangibles such as software rights. Distribution rights relate to amounts that have been paid or have become unconditionally due for payment as a result of past events in respect of bancassurance partnership arrangements in Asia. These agreements allow for bank distribution of Prudential's insurance products for a fixed period of time. Software rights include additions of £34 million, amortisation of £32 million, foreign exchange losses of £7 million and a balance at 31 December 2018 of £62 million.

† Under the Group's application of IFRS 4, US GAAP is used for measuring the insurance assets and liabilities of its US and certain Asia operations. Under US GAAP, most of the US insurance operation's products are accounted for under Accounting Standards Codification Topic 944, Financial Services – Insurance, of the Financial Accounting Standards Board whereby deferred acquisition costs are amortised in line with the emergence of actual and expected gross profits which are determined using an assumption for long-term investment returns for the separate account of 7.4 per cent (2017: 7.4 per cent) (gross of asset management fees and other charges to policyholders, but net of external fund management fees). The amounts included in the income statement and other comprehensive income affect the pattern of profit emergence and thus the DAC amortisation attaching. DAC amortisation is allocated to the operating and non-operating components of the Group's supplementary analysis of profit and other comprehensive income by reference to the underlying items (see note C7.3(iv)).

(b) The DAC amount in respect of US insurance operations comprises amounts in respect of:

	31 Dec 2018 £m	31 Dec 2017 £m
Variable annuity business	**8,477**	8,208
Other business	**299**	278
Cumulative shadow DAC (for unrealised gains booked in other comprehensive income)*	**(49)**	(289)
Total DAC for US operations	**8,727**	8,197

* A gain of £246 million (2017: a loss of £(76) million) for shadow DAC amortisation is booked within other comprehensive income to reflect the impact from the negative unrealised valuation movement in 2018 of £1,617 million (2017: positive unrealised valuation movement of £617 million). These adjustments reflect movement from period to period, in the changes to the pattern of reported gross profits that would have occurred if the assets reflected in the statement of financial position had been sold, crystallising the unrealised gains and losses, and the proceeds reinvested at the yields currently available in the market. At 31 December 2018, the cumulative shadow DAC balance as shown in the table above was negative £49 million (31 December 2017: negative £289 million).

(c) Sensitivity of amortisation charge

The amortisation charge to the income statement is reflected in both adjusted IFRS operating profit based on longer-term investment returns and short-term fluctuations in investment returns. The amortisation charge to adjusted IFRS operating profit based on longer-term investment returns in a reporting period comprises:

– A core amount that reflects a relatively stable proportion of underlying premiums or profit; and

– An element of acceleration or deceleration arising from market movements differing from expectations.

In periods where the cap and floor feature of the mean reversion technique (which is used for moderating the effect of short-term volatility in investment returns) are not relevant, the technique operates to dampen the second element above. Nevertheless, extreme market movements can cause material acceleration or deceleration of amortisation in spite of this dampening effect.

Furthermore, in those periods where the cap or floor is relevant, the mean reversion technique provides no further dampening and additional volatility may result.

In 2018, the DAC amortisation charge for adjusted IFRS operating profit based on longer-term investment returns was determined after including a debit for accelerated amortisation of £194 million (2017: credit for decelerated amortisation of £86 million). The acceleration arising in 2018 reflects a mechanical increase in the projected separate account return for the next five years under the mean-reversion technique. Under this technique the projected level of return for each of the next five years is adjusted so that in combination with the actual rates of return for the preceding three years (including the current period) the assumed long-term annual separate account return of 7.4 per cent is realised on average over the entire eight-year period. The acceleration in DAC amortisation in 2018 is driven both by the actual separate return in the year being lower than that assumed and by the lower than expected return in 2015 falling out of the eight-year period in effect reversing the deceleration experienced in 2015 under the mean reversion formula.

The application of the mean reversion formula has the effect of dampening the impact of equity market movements on DAC amortisation while the mean reversion assumption lies within the corridor. At 31 December 2018, it would take approximate movements in separate account values of more than either negative 22 per cent or positive 57 per cent (31 December 2017: negative 32 per cent or positive 37 per cent) for the mean reversion assumption to move outside the corridor.

C6 Borrowings

C6.1 Core structural borrowings of shareholder-financed businesses

	31 Dec 2018 £m	31 Dec 2017 £m
Holding company operations: note (i)		
Perpetual Subordinated Capital Securities (Tier 1)	**431**	814
Perpetual Subordinated Capital Securities (Tier 2) note (v)	**2,478**	2,326
Subordinated Notes (Tier 2) note (iv)	**3,767**	2,132
Subordinated debt total	**6,676**	5,272
Senior debt: note (ii)		
£300m 6.875% Bonds 2023	**294**	300
£250m 5.875% Bonds 2029	**223**	249
Bank loan note (iii)	**275**	–
Holding company total	**7,468**	5,821
Prudential Capital bank loan note (iii)	**–**	275
Jackson US$250m 8.15% Surplus Notes 2027	**196**	184
Total (per consolidated statement of financial position)	**7,664**	6,280

Notes

(i) These debt tier classifications are consistent with the treatment of capital for regulatory purposes under the Solvency II regime.
The Group has designated US$3,725 million (31 December 2017: US$4,275 million) of its US dollar denominated subordinated debt as a net investment hedge under IAS 39 to hedge the currency risks related to the net investment in Jackson.

(ii) The senior debt ranks above subordinated debt in the event of liquidation. In 2018, as part of its preparation to demerge M&GPrudential, the Group made certain modifications to the terms and conditions of the senior bonds with bondholders' consent. The amendment to the terms and conditions will avoid an event of a technical default on the bonds, should the demerger proceed. The fees paid to bondholders have been adjusted to the carrying value of the bonds and will be amortised in subsequent periods. No other adjustments were made to the carrying value of the debt as a result of the modification.

(iii) The bank loan of £275 million is drawn at a cost of 12-month GBP LIBOR plus 0.33 per cent. The loan, held by Prudential Capital as of 31 December 2017, was renewed in December 2018, with Prudential plc becoming the new holder. The loan matures on 20 December 2022 with an option to repay annually.

(iv) In October 2018, the Company issued the following three substitutable core structural borrowings as part of the process required before demerger to rebalance debt across M&GPrudential and Prudential (see below):
- £750 million 5.625 per cent Tier 2 subordinated notes due 2051. The proceeds, net of costs, were £743 million;
- £500 million 6.25 per cent Tier 2 subordinated notes due 2068. The proceeds, net of costs, were £498 million; and
- US$500 million 6.5 per cent Tier 2 subordinated notes due 2048. The proceeds, net of costs, were £389 million (US$498 million).

(v) In December 2018, the Company paid £434 million to redeem its US$550 million 7.75 per cent Tier 1 perpetual subordinated notes.

Prior to the demerger, the Group expects to rebalance its debt capital across Prudential and M&GPrudential. This will include the ultimate holding company of M&GPrudential becoming an issuer of new debt, including debt substituted from Prudential, and Prudential redeeming some of its existing debt. Following these actions, the overall absolute quantum of debt across Prudential and M&GPrudential is currently expected to increase, by an amount which is not considered to be material in the context of the Group's total outstanding debt as at 30 June 2018, before any substitutable debt had been issued, of £7.6 billion (comprising the Group's core structural borrowings of £6.4 billion and shareholder borrowings from short-term fixed income securities programme of £1.2 billion). At the time of the demerger, Prudential expects M&GPrudential to be holding around £3.5 billion of subordinated debt. This expectation is subject to the M&GPrudential capital risk appetite being approved by the Board of the ultimate holding company of M&GPrudential, once fully constituted to include independent non-executive directors, and reflects the current operating environment and economic conditions, material changes in which may lead to a different outcome.

Ratings

Prudential plc has debt ratings from Standard & Poor's, Moody's and Fitch. Prudential plc's long-term senior debt is rated A2 by Moody's, A by Standard & Poor's and A- by Fitch.

Prudential plc's short-term debt is rated as P-1 by Moody's, A-1 by Standard & Poor's and F1 by Fitch.

The financial strength of The Prudential Assurance Company Limited is rated A+ by Standard & Poor's, Aa3 by Moody's and AA- by Fitch.

Jackson National Life Insurance Company's financial strength is rated AA- by Standard & Poor's and Fitch, A1 by Moody's and A+ by A.M. Best.

Prudential Assurance Co. Singapore (Pte) Ltd.'s (Prudential Singapore) financial strength is rated AA- by Standard & Poor's.

All the Group's ratings are on a stable outlook.

C6.2 Other borrowings

(i) Operational borrowings attributable to shareholder-financed businesses

	31 Dec 2018 £m	31 Dec 2017 £m
Borrowings in respect of short-term fixed income securities programmes	**472**	1,085
Other borrowings[note]	**526**	706
Total	**998**	1,791

Note
Other borrowings mainly include senior debt issued through the Federal Home Loan Bank of Indianapolis (FHLB), secured by collateral posted with the FHLB by Jackson. In addition, other borrowings include amounts whose repayment to the lender is contingent upon future surplus emerging from certain contracts specified under the arrangement. If insufficient surplus emerges on those contracts, there is no recourse to other assets of the Group and the liability is not payable to the degree of shortfall.

(ii) Borrowings attributable to with-profits businesses

	31 Dec 2018 £m	31 Dec 2017 £m
Non-recourse borrowings of consolidated investment funds*	**3,845**	3,570
£100m 8.5% undated subordinated guaranteed bonds of Scottish Amicable Finance plc†	**–**	100
Other borrowings (including obligations under finance leases)	**95**	46
Total	**3,940**	3,716

* In all instances the holders of the debt instruments issued by these subsidiaries and funds do not have recourse beyond the assets of these subsidiaries and funds.

† The interests of the holders of the bonds issued by Scottish Amicable Finance plc, a subsidiary of the Scottish Amicable Insurance Fund, are subordinated to the entitlements of the policyholders of that fund. These bonds were redeemed in full on 30 June 2018.

C7 Risk and sensitivity analysis

C7.1 Group overview

The Group's risk framework and the management of the risk, including those attached to the Group's financial statements including financial assets, financial liabilities and insurance liabilities, together with the inter-relationship with the management of capital have been included in the 'Chief Risk Officer's Report on the risks facing our business and how these are managed'.

The financial and insurance assets and liabilities on the Group's balance sheet are, to varying degrees, subject to market and insurance risk and other changes of experience assumptions that may have a material effect on IFRS basis profit or loss and shareholders' equity. The market and insurance risks, including how they affect Group's operations and how these are managed are discussed in the Risk report referred to above.

The most significant items that the IFRS shareholders' profit or loss and shareholders' equity for the Group's life assurance business are sensitive to, are shown in the following tables. The distinction between direct and indirect exposure is not intended to indicate the relative size of the sensitivity.

Type of business	Market and credit risk: Investments/derivatives	Market and credit risk: Liabilities/unallocated surplus	Market and credit risk: Other exposure	Insurance and lapse risk
Asia insurance operations (see also section C7.2)				
All business	Currency risk			Mortality and morbidity risk Persistency risk
With-profits business	Net neutral direct exposure (indirect exposure only)		Investment performance subject to smoothing through declared bonuses	
Unit-linked business	Net neutral direct exposure (indirect exposure only)		Investment performance through asset management fees	
Non-participating business	Asset/liability mismatch risk			
	Credit risk	Interest rates for those operations where the basis of insurance liabilities is sensitive to current market movements		
	Interest rate and price risk			
US insurance operations (see also section C7.3)				
All business	Currency risk			Persistency risk
Variable annuity business	Net effect of market risk arising from incidence of guarantee features and variability of asset management fees offset by derivative hedging programme			Risk that utilisation of withdrawal benefits or lapse levels differ from those assumed in pricing
Fixed index annuity business	Derivative hedge programme to the extent not fully hedged against liability	Incidence of equity participation features		
Fixed index annuities, Fixed annuities and GIC business	Credit risk Interest rate risk Profit and loss and shareholders' equity are volatile for these risks as they affect the values of derivatives and embedded derivatives and impairment losses. In addition, shareholders' equity is volatile for the incidence of these risks on unrealised appreciation of fixed income securities classified as available-for-sale under IAS 39		Spread difference between earned rate and rate credited to policyholders	Lapse risk, but the effects of extreme events may be mitigated by the application of market value adjustments
UK and Europe insurance operations (see also section C7.4)				
With-profits business	Net neutral direct exposure (indirect exposure only)		Investment performance subject to smoothing through declared bonuses	Persistency risk to future shareholder transfers
SAIF sub-fund	Net neutral direct exposure (indirect exposure only)		Asset management fees earned	
Unit-linked business	Net neutral direct exposure (indirect exposure only)		Investment performance through asset management fees	Persistency risk
	Asset/liability mismatch risk			
Shareholder-backed annuity business	Credit risk for assets covering liabilities and shareholder capital Interest rate risk for assets in excess of liabilities, ie assets representing shareholder capital			Mortality experience and assumptions for longevity

Detailed analyses of sensitivity of IFRS basis profit or loss and shareholders' equity to key market and other risks by business unit are provided in notes C7.2, C7.3, C7.4 and C7.5. The sensitivity analyses provided show the effect on profit or loss and shareholders' equity to changes in the relevant risk variables, all of which are reasonably possible at the relevant balance sheet date. In the equity risk sensitivity analysis shown below, the Group has considered the impact of an instantaneous 20 per cent fall in equity markets. If equity markets were to fall by more than 20 per cent, the Group believes that this would not be an instantaneous fall but rather would be expected to occur over a period of time during which the Group would be able to put mitigating management actions in place. In addition, the equity risk sensitivity analysis provided assumed that all equity indices fall by the same percentage.

Impact of diversification on risk exposure
The Group benefits from diversification benefits achieved through the geographical spread of the Group's operations and, within those operations, through a broad mix of product types. Relevant correlation factors include:

Correlation across geographic regions:
- Financial risk factors; and
- Non-financial risk factors.

Correlation across risk factors:
- Longevity risk;
- Expenses;
- Persistency; and
- Other risks.

The sensitivities below do not reflect that assets and liabilities are actively managed and may vary at the time any actual market movement occurs. There are strategies in place to minimise the exposure to market fluctuations. For example, as market indices fluctuate, Prudential would take certain actions including selling investments, changing investment portfolio allocation and adjusting bonuses credited to policyholders. In addition, these analyses do not consider the effect of market changes on new business generated in the future.

Other limitations on the sensitivities include: the use of hypothetical market movements to demonstrate potential risk that only represent Prudential's view of reasonably possible near-term market changes and that cannot be predicted with any certainty; the assumption that interest rates in all countries move identically; the assumption that all global currencies move in tandem with the US dollar against pound sterling; and the lack of consideration of the inter-relation of interest rates, equity markets and foreign currency exchange rates.

C7.2 Asia insurance operations

Exposure and sensitivity of IFRS basis profit and shareholders' equity to market and other risks
The Asia operations sell with-profits and unit-linked policies, and the investment portfolio of the with-profits funds contains a proportion of equities. Non-participating business is largely backed by debt securities or deposits. The Group's exposure to market risk arising from its Asia operations is therefore at modest levels. This reflects the fact that the Asia operations have a balanced portfolio of with-profits, unit-linked and other types of business.

In Asia, adverse persistency experience can impact the IFRS profitability of certain types of business written in the region. This risk is managed at a business unit level through regular monitoring of experience and the implementation of management actions as necessary. These actions could include product enhancements, increased management focus on premium collection, as well as other customer retention efforts. The potential financial impact of lapses is often mitigated through the specific features of the products, eg surrender charges, or through the availability of premium holiday or partial withdrawal policy features.

In summary, for Asia operations, the adjusted IFRS operating profit based on longer-term investment returns is mainly affected by the impact of market levels on unit-linked persistency, and other insurance risks. At the total IFRS profit level the Asia result is affected by short-term value movements on the asset portfolio for non-linked shareholder-backed business.

(i) Sensitivity to risks other than foreign exchange risk
Interest rate risk
Excluding its with-profits and unit-linked businesses, the results of the Asia business are sensitive to the movements in interest rates.

For the purposes of analysing sensitivity to variations in interest rates, reference has been made to the movements in the 10-year government bond rates of the territories. At 31 December 2018, 10-year government bond rates vary from territory to territory and range from 0.9 per cent to 8.1 per cent (31 December 2017: 1.0 per cent to 7.5 per cent).

For the sensitivity analysis as shown in the table below, the reasonably possible interest rate movement used is 1 per cent for all local business units.

The estimated sensitivity to the decrease and increase in interest rates is as follows:

	2018 £m		2017 £m	
	Decrease of 1%	**Increase of 1%**	**Decrease of 1%**	**Increase of 1%**
Profit before tax attributable to shareholders	**312**	**(338)**	2	(443)
Related deferred tax (where applicable)	**(15)**	**26**	(7)	20
Net effect on profit and shareholders' equity	**297**	**(312)**	(5)	(423)

The pre-tax impacts, if they arose, would mostly be recorded within the category short-term fluctuations in investments returns in the Group's segmental analysis of profit before tax.

The degree of sensitivity of the results of the non-linked shareholder-backed business of the Asia operations to movements in interest rates depends upon the degree to which the liabilities under the 'grandfathered' IFRS 4 measurement basis reflects market interest rates from period-to-period. For example for countries applying US GAAP the results can be more sensitive as the effect of interest rate movements on the backing investments may not be offset by liability movements.

In addition, the degree of sensitivity of the results shown in the table above is dependent on the interest rate level at that point of time.

An additional factor to the direction of the sensitivity of the Asia operations as a whole is movement in the country mix.

Equity price risk
The non-linked shareholder-backed business has limited exposure to equity and property investment (31 December 2018: £2,151 million; 31 December 2017: £1,764 million). Generally, changes in equity and property investment values are not directly offset by movements in non-linked policyholder liabilities.

The estimated sensitivity to a 10 per cent and 20 per cent change in equity and property prices for shareholder-backed Asia other business (including those held by the Group's joint venture and associate businesses), which would be reflected in the short-term fluctuation component of the Group's segmental analysis of profit before tax, is as follows:

	2018 £m		2017 £m	
	Decrease		**Decrease**	
	of 20%	**of 10%**	**of 20%**	**of 10%**
Profit before tax attributable to shareholders	**(557)**	**(279)**	(478)	(239)
Related deferred tax (where applicable)	**17**	**8**	7	4
Net effect on profit and shareholders' equity	**(540)**	**(271)**	(471)	(235)

A 10 or 20 per cent increase in equity and property values would have an approximately equal and opposite effect on profit and shareholders' equity to the sensitivities shown above.

Insurance risk
Many of the business units in Asia are exposed to mortality/morbidity risk and provision is made within policyholder liabilities on a prudent regulatory basis to cover the potential exposure. If these prudent assumptions were strengthened by 5 per cent then it is estimated that post-tax profit and shareholders' equity would be decreased by approximately £57 million (2017: £66 million). Mortality and morbidity have a broadly symmetrical effect on the portfolio and any weakening of these assumptions would have a similar equal and opposite impact.

(ii) Sensitivity to foreign exchange risk
Consistent with the Group's accounting policies, the profits of the Asia insurance operations are translated at average exchange rates and shareholders' equity at the closing rate for the reporting period. For 2018, the rates for the most significant operations are given in note A1.

A 10 per cent increase (strengthening of the pound sterling) or decrease (weakening of the pound sterling) in these rates would have reduced or increased profit before tax attributable to shareholders, profit for the year and shareholders' equity, excluding goodwill attributable to Asia insurance operations respectively as follows:

	A 10% increase in local currency to £ exchange rates		A 10% decrease in local currency to £ exchange rates	
	2018 £m	**2017 £m**	**2018 £m**	**2017 £m**
Profit before tax attributable to shareholders	**(134)**	(155)	**164**	189
Profit for the year	**(113)**	(135)	**138**	165
Shareholders' equity, excluding goodwill, attributable to Asia operations	**(543)**	(492)	**664**	601

C7.3 US insurance operations

Exposure and sensitivity of IFRS basis profit and shareholders' equity to market and other risks
Jackson's reported adjusted IFRS operating profit based on longer-term investment returns is sensitive to market conditions, both with respect to income earned on spread-based products and indirectly with respect to income earned on variable annuity asset management fees. Jackson's main exposures to market risk are to interest rate risk and equity risk.

Jackson is exposed primarily to the following risks:

Risks	Risk of loss
Equity risk	— Related to the incidence of benefits related to guarantees issued in connection with its variable annuity contracts; and — Related to meeting contractual accumulation requirements in fixed index annuity contracts.
Interest rate risk	— Related to meeting guaranteed rates of accumulation on fixed annuity products following a sustained fall in interest rates; — Related to increases in the present value of projected benefits related to guarantees issued in connection with its variable annuity contracts following a sustained fall in interest rates especially if in conjunction with a fall in equity markets; — Related to the surrender value guarantee features attached to the Company's fixed annuity products and to policyholder withdrawals following a sharp and sustained increase in interest rates; and — The risk of mismatch between the expected duration of certain annuity liabilities and prepayment risk and extension risk inherent in mortgage-backed securities.

Jackson's derivative programme is used to manage interest rate risk associated with a broad range of products and equity market risk attaching to its equity-based products. Movements in equity markets, equity volatility, interest rates and credit spreads materially affect the carrying value of derivatives that are used to manage the liabilities to policyholders and backing investment assets. Movements in the carrying value of derivatives combined with the use of US GAAP measurement (as 'grandfathered' under IFRS 4) for the insurance contracts assets and liabilities, which is largely insensitive to current period market movements, mean that the Jackson total profit (ie including short-term fluctuations in investment returns) is sensitive to market movements. In addition to these effects the Jackson shareholders' equity is sensitive to the impact of interest rate and credit spread movements on the value of fixed income securities. Movements in unrealised appreciation on these securities are included as movement in shareholders' equity (ie outside the income statement).

Jackson enters into financial derivative transactions, including those noted below, to reduce and manage business risks. These transactions manage the risk of a change in the value, yield, price, cash flows or quantity of, or a degree of exposure, with respect to assets, liabilities or future cash flows, which Jackson has acquired or incurred.

Jackson uses free-standing derivative instruments for hedging purposes. Additionally, certain liabilities, primarily trust instruments supported by funding agreements, fixed index annuities, certain variable annuity guaranteed benefit features and reinsured Guaranteed Minimum Income Benefit variable annuity features are similar to derivatives. Jackson does not account for such items as either fair value or cash flow hedges as might be permitted if the specific hedge documentation requirements of IAS 39 were followed. Financial derivatives are carried at fair value, including derivatives embedded in certain host liabilities where these are required to be valued separately.

The principal types of derivatives used by Jackson and their purpose are as follows:

Derivative	Purpose
Interest rate swaps	These generally involve the exchange of fixed and floating payments over the period for which Jackson holds the instrument without an exchange of the underlying principal amount. These agreements are used to hedge Jackson's exposure to movements in interest rates.
Swaption contracts	These contracts provide the purchaser with the right, but not the obligation, to require the writer to pay the present value of a long-duration interest rate swap at future exercise dates. Jackson both purchases and writes swaptions in order to hedge against significant movements in interest rates.
Treasury futures contracts	These derivatives are used to hedge Jackson's exposure to movements in interest rates.
Equity index futures contracts and equity index options	These derivatives (including various call and put options and options contingent on interest rates and currency exchange rates) are used to hedge Jackson's obligations associated with its issuance of certain VA guarantees. Some of these annuities and guarantees contain embedded options that are fair valued for financial reporting purposes.
Cross-currency swaps	Cross-currency swaps, which embody spot and forward currency swaps and additionally, in some cases, interest rate swaps and equity index swaps, are entered into for the purpose of hedging Jackson's foreign currency denominated funding agreements supporting trust instrument obligations.
Credit default swaps	These swaps represent agreements under which the buyer has purchased default protection on certain underlying corporate bonds held in its portfolio. These contracts allow Jackson to sell the protected bonds at par value to the counterparty if a default event occurs in exchange for periodic payments made by Jackson for the life of the agreement.

The estimated sensitivity of Jackson's profit and shareholders' equity to equity and interest rate risks provided below is net of the related changes in amortisation of DAC. The effect on the related changes in amortisation of DAC provided is based on the current 'grandfathered' US GAAP DAC basis but does not include any effect from an acceleration or deceleration of amortisation of DAC.

(i) Sensitivity to equity risk

Jackson had variable annuity contracts with guarantees, for which the net amount at risk (NAR) is defined as the amount of guaranteed benefit in excess of current account value, as follows:

31 December 2018	Minimum return %	Account value £m	Net amount at risk £m	Weighted average attained age Years	Period until expected annuitisation Years
Return of net deposits plus a minimum return					
GMDB	**0-6%**	**98,653**	**4,437**	**66.5 years**	
GMWB – premium only	**0%**	**1,924**	**62**		
GMWB*	**0-5%**†	**197**	**20**		
GMAB – premium only	**0%**	**26**	**–**		
Highest specified anniversary account value minus withdrawals post-anniversary					
GMDB		**8,531**	**1,113**	**67.1 years**	
GMWB – highest anniversary only		**2,220**	**314**		
GMWB*		**535**	**89**		
Combination net deposits plus minimum return, highest specified anniversary account value minus withdrawals post-anniversary					
GMDB	**0-6%**	**5,454**	**1,217**	**69.5 years**	
GMIB‡	**0-6%**	**1,256**	**648**		**0.1 years**
GMWB*	**0-8%**†	**91,788**	**16,835**		

31 December 2017	Minimum return %	Account value £m	Net amount at risk £m	Weighted average attained age Years	Period until expected annuitisation Years
Return of net deposits plus a minimum return					
GMDB	0-6%	100,451	1,665	66.0 years	
GMWB – premium only	0%	2,133	20		
GMWB*	0-5%†	235	13		
GMAB – premium only	0%	38	–		
Highest specified anniversary account value minus withdrawals post-anniversary					
GMDB		9,099	96	66.5 years	
GMWB – highest anniversary only		2,447	51		
GMWB*		667	47		
Combination net deposits plus minimum return, highest specified anniversary account value minus withdrawals post-anniversary					
GMDB	0-6%	5,694	426	69.0 years	
GMIB‡	0-6%	1,484	436		0.4 years
GMWB*	0-8%†	93,227	4,393		

* Amounts shown for GMWB comprise sums for the 'not for life' portion (where the guaranteed withdrawal base less the account value equals to the net amount at risk (NAR)), and a 'for life' portion (where the NAR has been estimated as the present value of future expected benefit payment remaining after the amount of the 'not for life' guaranteed benefits is zero).

† Ranges shown based on simple interest. The upper limits of 5 per cent or 8 per cent simple interest are approximately equal to 4.1 per cent and 6 per cent respectively, on a compound interest basis over a typical 10-year bonus period. For example 1 + 10 x 0.05 is similar to 1.04 growing at a compound rate of 4 per cent for a further nine years.

‡ The GMIB guarantees are substantially reinsured.

Account balances of contracts with guarantees were invested in variable separate accounts as follows:

Mutual fund type:	31 Dec 2018 £m	31 Dec 2017 £m
Equity	**78,387**	80,843
Bond	**13,901**	13,976
Balanced	**19,903**	19,852
Money market	**824**	681
Total	**113,015**	115,352

As noted above, Jackson is exposed to equity risk through the options embedded in the fixed index annuity liabilities and guarantees included in certain variable annuity benefits as illustrated above. This risk is managed using an equity hedging programme to minimise the risk of a significant economic impact as a result of increases or decreases in equity market levels. Jackson purchases futures and options that hedge the risks inherent in these products, while also considering the impact of rising and falling guaranteed benefit fees.

Due to the nature of valuation under IFRS of the free-standing derivatives and the variable annuity guarantee features, this hedge, while highly effective on an economic basis, would not automatically offset within the financial statements as the impact of equity market movements resets the free-standing derivatives immediately while the hedged liabilities reset more slowly and fees are recognised prospectively in the period in which they are earned.

In addition to the exposure explained above, Jackson is also exposed to equity risk from its holding of equity securities, partnerships in investment pools and other financial derivatives.

The estimated sensitivity of Jackson's profit and shareholders' equity to immediate increases and decreases in equity markets is shown below. The sensitivities are shown net of related changes in DAC amortisation, as described above.

	31 Dec 2018 £m				31 Dec 2017 £m			
	Decrease		Increase		Decrease		Increase	
	of 20%	of 10%	of 20%	of 10%	of 20%	of 10%	of 20%	of 10%
Pre-tax profit, net of related changes in amortisation of DAC	**1,058**	**427**	**58**	**(125)**	1,107	336	619	262
Related deferred tax effects	**(222)**	**(90)**	**(12)**	**26**	(233)	(71)	(130)	(55)
Net sensitivity of profit after tax and shareholders' equity*	**836**	**337**	**46**	**(99)**	874	265	489	207

* The table above has been prepared to exclude the impact of the instantaneous equity movements on the separate account fees. In addition, the sensitivity movements shown include those relating to the fixed index annuity and the reinsurance of GMIB guarantees.

The above table provides sensitivity movements at a point in time while the actual impact on financial results would vary contingent upon the volume of new product sales and lapses, changes to the derivative portfolio, correlation of market returns and various other factors including volatility, interest rates and elapsed time.

The directional movements in the sensitivities reflect the hedging programme in place at 31 December 2018 and 2017.

(ii) Sensitivity to interest rate risk

Except in the circumstances of interest rate scenarios where the guarantee rates included in contract terms are higher than crediting rates that can be supported from assets held to cover liabilities, the accounting measurement of fixed annuity liabilities of Jackson's products is not generally sensitive to interest rate risk. This position derives from the nature of the products and the US GAAP basis of measurement. The GMWB features attached to variable annuity business (other than 'for life' components) are accounted for under US GAAP at fair-value and, therefore, will be sensitive to changes in interest rates.

Debt securities and related derivatives are marked to fair value. Value movements on derivatives, again net of related changes to amortisation of DAC and deferred tax, are recorded within the income statement. Fair value movements on debt securities, net of related changes to amortisation of DAC and deferred tax, are recorded within other comprehensive income. The estimated sensitivity of these items and policyholder liabilities to a 1 per cent and 2 per cent decrease and increase in interest rates is as follows:

	31 Dec 2018 £m				31 Dec 2017 £m			
	Decrease		Increase		Decrease		Increase	
	of 2%	of 1%	of 1%	of 2%	of 2%	of 1%	of 1%	of 2%
Profit and loss:								
Pre-tax profit effect (net of related changes in amortisation of DAC)	**(3,535)**	**(1,718)**	**1,201**	**2,210**	(4,079)	(1,911)	1,373	2,533
Related effect on charge for deferred tax	**742**	**361**	**(252)**	**(464)**	857	401	(288)	(532)
Net profit effect	**(2,793)**	**(1,357)**	**949**	**1,746**	(3,222)	(1,510)	1,085	2,001
Other comprehensive income:								
Direct effect on carrying value of debt securities (net of related changes in amortisation of DAC)	**4,134**	**2,346**	**(2,346)**	**(4,134)**	3,063	1,700	(1,700)	(3,063)
Related effect on movement in deferred tax	**(868)**	**(493)**	**493**	**868**	(643)	(357)	357	643
Net effect	**3,266**	**1,853**	**(1,853)**	**(3,266)**	2,420	1,343	(1,343)	(2,420)
Total net effect on shareholders' equity	**473**	**496**	**(904)**	**(1,520)**	(802)	(167)	(258)	(419)

These sensitivities are shown for interest rates in isolation only and do not include other movements in credit risk that may affect credit spreads and valuations of debt securities. Similar to the sensitivity to equity risk, the sensitivity movements provided in the table above are at a point in time and reflect the hedging programme in place on the balance sheet date, while the actual impact on financial results would vary contingent upon a number of factors.

(iii) Sensitivity to foreign exchange risk

Consistent with the Group's accounting policies, the profits of the Group's US operations are translated at average exchange rates and shareholders' equity at the closing rate for the reporting period. For 2018, the average and closing rates were US$1.34 (31 December 2017: US$1.29) and US$1.27 (31 December 2017: US$1.35) to £1.00 sterling respectively. A 10 per cent increase (weakening of the dollar) or decrease (strengthening of the dollar) in these rates would reduce or increase profit before tax attributable to shareholders, profit for the year and shareholders' equity attributable to US insurance operations respectively as follows:

	A 10% increase in US$:£ exchange rates		A 10% decrease in US$:£ exchange rates	
	2018 £m	2017 £m	2018 £m	2017 £m
Profit before tax attributable to shareholders	**(159)**	(54)	**194**	66
Profit for the year	**(136)**	(20)	**166**	24
Shareholders' equity attributable to US insurance operations	**(508)**	(456)	**620**	557

(iv) Other sensitivities
The total profit of Jackson is sensitive to market risk on the assets covering liabilities other than variable annuity business segregated in the separate accounts.

For term business, acquisition costs are deferred and amortised in line with expected premiums. For annuity and interest-sensitive life business, acquisition costs are deferred and amortised in line with expected gross profits on the relevant contracts. For interest-sensitive business, the key assumption is the expected long-term spread between the earned rate and the rate credited to policyholders. In addition, expected gross profits depend on mortality assumptions, assumed unit costs and terminations other than deaths (including the related charges) all of which are based on a combination of actual experience of Jackson, industry benchmarking and future expectations. A detailed analysis of actual experience is measured by internally developed expense, mortality and persistency studies.

For variable annuity business, an assumption made is the expected long-term level of separate account returns, which for 2018 was 7.4 per cent (2017: 7.4 per cent). The impact of using this return is reflected in two principal ways, namely:

— Through the projected expected gross profits that are used to determine the amortisation of deferred acquisition costs. This is applied through the use of a mean reversion technique; and
— The required level of provision for claims for guaranteed minimum death, ‘for life’ withdrawal, and income benefits.

Jackson is sensitive to mortality risk, lapse risk and other types of policyholder behaviour, such as the utilisation of its GMWB product features. Jackson’s persistency assumptions reflect a combination of recent experience for each relevant line of business and expert judgement, especially where a lack of relevant and credible experience data exists. These assumptions vary by relevant factors, such as product, policy duration, attained age and for variable annuity lapse assumptions, the extent to which guaranteed benefits are ‘in the money’ relative to policy account values. Changes in these assumptions, which are assessed on an annual basis after considering recent experience, could have a material impact on policyholder liabilities and therefore on profit before tax. See further information in note B1.2.

In addition, in the absence of hedging, equity and interest rate movements can both cause a loss directly or an increased future sensitivity to policyholder behaviour. Jackson has an extensive derivative programme that seeks to manage the exposure to such altered equity markets and interest rates.

C7.4 UK and Europe insurance operations

Exposure and sensitivity of IFRS basis profit and shareholders’ equity to market and other risks
The IFRS basis results of the shareholder-backed business for the UK and Europe insurance operations are most sensitive to the following factors:

— Asset/liability matching;
— Default rate experience;
— Annuitant mortality; and
— The difference between the rates of return on corporate bonds and risk-free rates.

Further details are described below.

The adjusted IFRS operating profit based on longer-term investment returns for UK and Europe insurance operations is sensitive to changes in longevity assumptions affecting the carrying value of liabilities to policyholders for UK shareholder-backed annuity business. At the total IFRS profit level, the result is particularly sensitive to temporary value movements on assets backing the capital of the shareholder-backed annuity business.

With-profits business

With-profits sub-fund business
The shareholder results of the UK with-profits business (including non-participating annuity business of the with-profits sub-fund) are only sensitive to market risk through the indirect effect of investment performance on declared policyholder bonuses.

The investment assets of UK with-profits funds are subject to market risk. Changes in their carrying value, net of related changes to asset-share liabilities of with-profits contracts, affect the level of unallocated surplus of the fund. Therefore, the level of unallocated surplus is particularly sensitive to the level of investment returns on the portion of the assets that represents surplus. However, as unallocated surplus is accounted for as a liability under IFRS, movements in its value do not affect shareholders’ profit and equity.

The shareholder results of the UK with-profits fund are currently one-ninth of the cost of bonuses declared to with-profits policyholders. For certain unitised with-profits products, such as the PruFund range of funds, the bonuses represent the policyholders’ net return based on the smoothed unit price of the selected investment fund. Investment performance is a key driver of bonuses declared, and hence the shareholder results. Due to the ‘smoothed’ basis of bonus declaration, the sensitivity to short-term investment performance is relatively low. However, longer-term investment performance and persistency trends may affect future shareholder transfers.

Shareholder-backed annuity business
Profits from shareholder-backed annuity business are most sensitive to:

- — The extent to which the duration of the assets held closely matches the expected duration of the liabilities under the contracts;
- — Actual versus expected default rates on assets held;
- — The difference between the rates of return on corporate bonds and risk-free rates;
- — The variance between actual and expected mortality experience;
- — The extent to which changes to the assumed rate of improvements in mortality give rise to changes in the measurement of liabilities; and
- — Changes in renewal expense levels.

In addition, the level of profit is affected by change in the level of reinsurance cover.

A decrease in assumed mortality rates of 1 per cent would decrease pre-tax profit by approximately £37 million (2017: £66 million). A decrease in credit default assumptions of five basis points would increase pre-tax profit by £99 million (2017: £198 million). A decrease in renewal expenses (excluding asset management expenses) of 5 per cent would increase pre-tax profit by £21 million (2017: £40 million). The effect on profit would be approximately symmetrical for changes in assumptions that are directionally opposite to those explained above. The net effect on profit after tax and shareholders' equity from all the changes in assumptions as described above would be an increase of approximately £69 million (2017: £143 million). See C4.1(d)(iii) for further details on mortality assumptions.

Unit-linked and other business
Unit-linked and other business represents a comparatively small proportion of the in-force business of the UK and Europe insurance operations.

Due to the matching of policyholder liabilities to attaching asset value movements, the UK unit-linked business is not directly affected by market or credit risk. The liabilities of other business are also broadly insensitive to market risk. Profits from unit-linked and similar contracts primarily arise from the excess of charges to policyholders for management of assets, over expenses incurred. The former is most sensitive to the net accretion of funds under management as a function of new business, persistency and timing of death. The accounting impact of the latter is dependent upon the amortisation of acquisition costs in line with the emergence of margins (for insurance contracts) and amortisation in line with service provision (for the investment management component of investment contracts). By virtue of the design features of most of the contracts that provide low levels of mortality cover, the profits are relatively insensitive to changes in mortality experience.

Sensitivity to interest rate risk and other market risk
By virtue of the fund structure, product features and basis of accounting, the policyholder liabilities of the UK and Europe insurance operations are, except annuity business, not generally exposed to interest rate risk. At 31 December 2018, annuity liabilities accounted for 95 per cent (31 December 2017: 98 per cent) of UK non-linked shareholder-backed business liabilities. For annuity business, liabilities are exposed to interest rate risk. However, the net exposure is substantially ameliorated by virtue of the close matching of assets with appropriate duration. The level of matching from period to period can vary depending on management actions and economic factors so it is possible for a degree of mis-matching profits or losses to arise.

The close matching by the Group of assets of appropriate duration to annuity liabilities is based on maintaining economic and regulatory capital. Liabilities are measured differently under Solvency II reporting requirements than under IFRS resulting in an alteration to the assets used to measure the IFRS annuity liabilities. As a result, IFRS has a different sensitivity to interest rate and credit risk than under Solvency II.

The estimated sensitivity of the UK non-linked shareholder-backed business (principally annuities business) to a movement in interest rates is as follows:

	31 Dec 2018 £m				31 Dec 2017 £m			
	A decrease of 2%	**A decrease of 1%**	**An increase of 1%**	**An increase of 2%**	**A decrease of 2%**	**A decrease of 1%**	**An increase of 1%**	**An increase of 2%**
Carrying value of debt securities and derivatives	**7,369**	**3,317**	**(2,792)**	**(5,193)**	13,497	5,805	(4,659)	(8,541)
Policyholder liabilities	**(4,784)**	**(2,162)**	**1,801**	**3,317**	(9,426)	(4,210)	3,443	6,295
Related deferred tax effects	**(446)**	**(199)**	**171**	**323**	(658)	(254)	190	348
Net sensitivity of profit after tax and shareholders' equity	**2,139**	**956**	**(820)**	**(1,553)**	3,413	1,341	(1,026)	(1,898)

In addition, the shareholder-backed portfolio of UK non-linked insurance operations (covering policyholder liabilities and shareholders' equity) includes equity securities and investment properties. Excluding any offsetting effects on the measurement of policyholder liabilities, a fall in their value would have given rise to the following effects on pre-tax profit, profit after tax and shareholders' equity.

	2018 £m		2017 £m	
	A decrease of 20%	**A decrease of 10%**	**A decrease of 20%**	**A decrease of 10%**
Pre-tax profit	**(336)**	**(168)**	(332)	(166)
Related deferred tax effects	**57**	**29**	57	28
Net sensitivity of profit after tax and shareholders' equity	**(279)**	**(139)**	(275)	(138)

A 10 or 20 per cent increase in their value would have an approximately equal and opposite effect on profit and shareholders' equity to the sensitivities shown above. The market risk sensitivities shown above reflect the impact of temporary market movements and, therefore, the primary effect of such movements would, in the Group's segmental analysis of profits, be included within the short-term fluctuations in investment returns.

C7.5 Asset management and other operations

(i) Asset management

(a) Sensitivities to foreign exchange risk

Consistent with the Group's accounting policies, the profits of Eastspring Investments and US asset management operations are translated at average exchange rates and shareholders' equity at the closing rate for the reporting period. The rates for the functional currencies of most significant operations are shown in note A1.

A 10 per cent increase in the relevant exchange rates (strengthening of the pound sterling) would have reduced reported profit before tax attributable to shareholders, and shareholders' equity excluding goodwill attributable to Eastspring Investments and US asset management operations, by £10 million and £43 million respectively (2017: £30 million and £53 million, respectively).

(b) Sensitivities to other financial risks for asset management operations

The profits of asset management businesses are sensitive to the level of assets under management, as this significantly affects the value of management fees earned by the business in the current and future periods. The Group's asset management operations do not hold significant investments in property or equities.

(ii) Other operations

The Group holds certain derivatives that are used to manage foreign currency movements and macroeconomic exposures. The fair value of these derivatives is sensitive to the combined effect of movements in exchange rates, interest rates and inflation rates. The possible permutations cover a wide range of scenarios. For indicative purposes, a reasonably possible range of fair value movements based on historical experience could be plus or minus £150 million.

Other operations are sensitive to credit risk on the loan portfolio of the Prudential Capital operation. Total debt securities held at 31 December 2018 by Prudential Capital were £1,884 million (2017: £2,238 million). Debt securities held by Prudential Capital are in general variable rate bonds and so market value is limited in sensitivity to interest rate movements and consequently any change in interest rates would not have a material impact on profit or shareholders' equity.

C8 Tax assets and liabilities

Deferred tax

The statement of financial position contains the following deferred tax assets and liabilities in relation to:

	2018 £m				
	At 1 Jan	Movement in income statement	Movement through other comprehensive income and equity	Other movements including foreign currency movements	At 31 Dec
Deferred tax assets					
Unrealised losses or gains on investments	**14**	**1**	**93**	**5**	**113**
Balances relating to investment and insurance contracts	**1**	**–**	**–**	**–**	**1**
Short-term temporary differences	**2,532**	**(266)**	**(8)**	**81**	**2,339**
Capital allowances	**14**	**–**	**–**	**1**	**15**
Unused tax losses	**66**	**23**	**–**	**38**	**127**
Total	**2,627**	**(242)**	**85**	**125**	**2,595**
Deferred tax liabilities					
Unrealised losses or gains on investments	**(1,748)**	**666**	**195**	**20**	**(867)**
Balances relating to investment and insurance contracts	**(872)**	**(91)**	**–**	**(39)**	**(1,002)**
Short-term temporary differences	**(2,041)**	**68**	**(15)**	**(109)**	**(2,097)**
Capital allowances	**(54)**	**(1)**	**–**	**(1)**	**(56)**
Total	**(4,715)**	**642**	**180**	**(129)**	**(4,022)**

Under IAS 12 'Income Taxes', deferred tax is measured at the tax rates that are expected to apply to the period when the asset is realised or the liability settled, based on the tax rates (and laws) that have been enacted or are substantively enacted at the end of the reporting period.

Deferred tax assets are recognised to the extent that they are regarded as recoverable, that is to the extent that, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying temporary differences can be deducted.

C9 Defined benefit pension schemes

(i) Background and summary economic and IAS 19 financial positions

The Group's businesses operate a number of pension schemes. The specific features of these schemes vary in accordance with the regulations of the country in which the employees are located, although they are, in general, funded by the Group and based either on a cash balance formula or on years of service and salary earned in the last year or years of employment. The largest defined benefit scheme is the principal UK scheme, namely the Prudential Staff Pension Scheme (PSPS). PSPS accounts for 82 per cent (2017: 82 per cent) of the underlying scheme liabilities of the Group's defined benefit schemes.

The Group also operates two smaller UK defined benefit schemes in respect of Scottish Amicable (SASPS) and M&G (M&GGPS). In addition, there are two small defined benefit schemes in Taiwan which have negligible deficits.

Under IAS 19, 'Employee Benefits' and IFRIC 14 'IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction', the Group is only able to recognise a surplus to the extent that it is able to access the surplus either through an unconditional right of refund or through reduced future contributions relating to ongoing service of active members. The Group has no unconditional right of refund to any surplus in PSPS. Accordingly, the PSPS surplus recognised is restricted to the present value of the economic benefit to the Group from the difference between the estimated future ongoing contributions and the full future cost of service for the active members. In contrast, the Group is able to access the surplus of SASPS and M&GGPS. Therefore, the amounts recognised for these schemes are the IAS 19 valuation amount (either a surplus or deficit).

The Group asset/liability in respect of defined benefit pension schemes is as follows:

	31 Dec 2018 £m					31 Dec 2017 £m				
	PSPS note (a)	**SASPS** note (b)	**M&GGPS**	**Other schemes**	**Total**	**PSPS** note (a)	**SASPS** note (b)	**M&GGPS**	**Other schemes**	**Total**
Underlying economic surplus (deficit)	**908**	**(79)**	**131**	**(1)**	**959**	721	(137)	109	(1)	692
Less: unrecognised surplus	**(677)**	**–**	**–**	**–**	**(677)**	(485)	–	–	–	(485)
Economic surplus (deficit) (including investment in Prudential insurance policies)[note (c)]	**231**	**(79)**	**131**	**(1)**	**282**	236	(137)	109	(1)	207
Attributable to:										
UK with-profits fund	**162**	**(32)**	**–**	**–**	**130**	165	(55)	–	–	110
Shareholder-backed business	**69**	**(47)**	**131**	**(1)**	**152**	71	(82)	109	(1)	97
Consolidation adjustment against policyholder liabilities for investment in Prudential insurance policies	**–**	**–**	**(225)**	**–**	**(225)**	–	–	(151)	–	(151)
IAS 19 pension asset (liability) on the Group statement of financial position[note (d)]	**231**	**(79)**	**(94)**	**(1)**	**57**	236	(137)	(42)	(1)	56

Notes

(a) No deficit or other funding is required for PSPS. Deficit funding, where applicable, is apportioned in the ratio of 70/30 between the UK with-profits fund and shareholder-backed business following detailed considerations in 2005 of the sourcing of previous contributions. Employer contributions for ongoing service of current employees are apportioned in the ratio relevant to current activity.

(b) The deficit of SASPS has been allocated 40 per cent to the UK with-profits fund and 60 per cent to the shareholders' fund as at 31 December 2018 and 2017.

(c) The underlying position on an economic basis reflects the assets (including investments in Prudential insurance policies that are offset against liabilities to policyholders on the Group consolidation) and the liabilities of the schemes.

(d) At 31 December 2018, the PSPS pension asset of £231 million (31 December 2017: £236 million) and the other schemes' pension liabilities of £174 million (31 December 2017: £180 million) are included within 'Other debtors' and 'Provisions' respectively on the consolidated statement of financial position.

Triennial actuarial valuations

Defined benefit pension schemes in the UK are generally required to be subject to full actuarial valuations every three years in order to assess the appropriate level of funding for schemes in relation to their commitments. These valuations include assessments of the likely rate of return on the assets held within the separate trustee administered funds. The actuarial valuation differs from the IAS 19 accounting basis valuation in a number of respects, including the discount rate assumption where IAS 19 prescribes a rate based on high-quality corporate bonds while a more 'prudent' assumption is used for the actuarial valuation.

The information on the latest completed actuarial valuation for the UK schemes is shown in the table below:

	PSPS	SASPS	M&GGPS
Last completed actuarial valuation date	5 April 2017	31 March 2017	31 December 2014*
Valuation actuary, all Fellows of the Institute and Faculty of Actuaries	C G Singer Towers Watson Limited	Jonathan Seed Xafinity Consulting Limited	Paul Belok AON Hewitt Limited
Funding level at the last valuation	105 per cent	75 per cent	99 per cent
Deficit funding arrangement agreed with the Trustees based on the last completed valuation	No deficit or other funding required. Ongoing contributions for active members are at the minimum level required under the scheme rules (approximately £5 million per annum excluding expenses)	Deficit funding of £26 million per annum from 1 April 2017 until 31 March 2027, or earlier if the scheme's funding level reaches 100 per cent before this date. The deficit funding will be reviewed every three years at subsequent valuations	No deficit funding required from 1 January 2016

*The triennial valuation for M&GGPS as at 31 December 2017 is currently in progress.

(ii) Assumptions

The actuarial assumptions used in determining benefit obligations and the net periodic benefit costs for the years shown were as follows:

	31 Dec 2018 %	31 Dec 2017 %
Discount rate*	**2.8**	2.5
Rate of increase in salaries	**3.3**	3.1
Rate of inflation†		
Retail prices index (RPI)	**3.3**	3.1
Consumer prices index (CPI)	**2.3**	2.1
Rate of increase of pensions in payment for inflation:		
PSPS:		
Guaranteed (maximum 5%)	**2.5**	2.5
Guaranteed (maximum 2.5%)	**2.5**	2.5
Discretionary	**2.5**	2.5
Other schemes	**3.3**	3.1

* The discount rate has been determined by reference to an 'AA' corporate bond index, adjusted where applicable to allow for the difference in duration between the index and the pension liabilities.

† The rate of inflation reflects the long-term assumption for UK RPI or CPI depending on the tranche of the schemes.

The calculations are based on current mortality estimates with an allowance made for expected future improvements in mortality. This allowance reflected the CMI 2015 Core projections model (2017: CMI 2014 projections model, with scheme-specific calibrations). In 2018, for members post retirement long-term mortality improvement rates of 1.75 per cent per annum (2017: 1.75 per cent per annum) and 1.50 per cent per annum (2017: 1.25 per cent per annum) were applied for males and females, respectively.

(iii) Estimated pension scheme surpluses and deficits

The underlying pension position on an economic basis reflects the assets (including investments in Prudential policies that are offset against liabilities to policyholders on the Group consolidation) and the liabilities of the schemes. The IAS 19 basis excludes the investments in Prudential policies. At 31 December 2018, M&GGPS held investments in Prudential insurance policies of £225 million (31 December 2017: £151 million).

Movements on the pension scheme surplus determined on the economic basis are as follows, with the effect of the application of IFRIC 14 being shown separately:

	2018 £m				
	Surplus (deficit) in schemes at 1 Jan 2018	**(Charge) credit to income statement**	**Actuarial gains and losses in other comprehensive income**	**Contributions paid**	**Surplus (deficit) in schemes at 31 Dec 2018**
All schemes					
Underlying position (without the effect of IFRIC 14)					
Surplus (deficit)	**692**	**(88)**	**303**	**52**	**959**
Less: amount attributable to UK with-profits fund	**(473)**	**38**	**(178)**	**(20)**	**(633)**
Shareholders' share:					
Gross of tax surplus (deficit)	**219**	**(50)**	**125**	**32**	**326**
Related tax	**(42)**	**10**	**(24)**	**(6)**	**(62)**
Net of shareholders' tax	**177**	**(40)**	**101**	**26**	**264**
Application of IFRIC 14 for the derecognition of PSPS surplus					
Derecognition of surplus	**(485)**	**(13)**	**(179)**	**–**	**(677)**
Less: amount attributable to UK with-profits fund	**363**	**8**	**132**	**–**	**503**
Shareholders' share:					
Gross of tax	**(122)**	**(5)**	**(47)**	**–**	**(174)**
Related tax	**23**	**1**	**9**	**–**	**33**
Net of shareholders' tax	**(99)**	**(4)**	**(38)**	**–**	**(141)**
With the effect of IFRIC 14					
Surplus (deficit)	**207**	**(101)**	**124**	**52**	**282**
Less: amount attributable to UK with-profits fund	**(110)**	**46**	**(46)**	**(20)**	**(130)**
Shareholders' share:					
Gross of tax surplus (deficit)	**97**	**(55)**	**78**	**32**	**152**
Related tax	**(19)**	**11**	**(15)**	**(6)**	**(29)**
Net of shareholders' tax	**78**	**(44)**	**63**	**26**	**123**

Underlying investments of the schemes

On the 'economic basis', after including the underlying assets represented by the investments in Prudential insurance policies as scheme assets, the plans' assets comprise the following investments:

	31 Dec 2018				31 Dec 2017			
	PSPS £m	**Other schemes £m**	**Total £m**	**%**	**PSPS £m**	**Other schemes £m**	**Total £m**	**%**
Equities								
UK	**8**	**6**	**14**	**–**	9	67	76	1
Overseas	**204**	**53**	**257**	**3**	226	272	498	6
Bonds								
Government	**4,596**	**538**	**5,134**	**61**	5,040	655	5,695	63
Corporate	**1,586**	**454**	**2,040**	**24**	1,491	248	1,739	20
Asset-backed securities	**263**	**12**	**275**	**3**	164	–	164	2
Derivatives	**103**	**4**	**107**	**1**	188	(6)	182	2
Properties	**143**	**143**	**286**	**3**	140	130	270	3
Other assets	**172**	**198**	**370**	**5**	216	77	293	3
Total value of assets	**7,075**	**1,408**	**8,483**	**100**	7,474	1,443	8,917	100

(iv) Sensitivity of the pension scheme liabilities to key variables

The sensitivity information below is based on the core scheme liabilities and assumptions at the balance sheet date. The sensitivities are calculated based on a change in one assumption with all other assumptions being held constant. As such, interdependencies between the assumptions are excluded. The impact of the rate of inflation assumption sensitivity includes the impact of inflation on the rate of increase in salaries and rate of increase of pensions in payment.

The sensitivities of the underlying pension scheme liabilities as shown below do not directly equate to the impact on the profit or loss attributable to shareholders or shareholders' equity due to the effect of the application of IFRIC 14 on PSPS and the allocation of a share of the interest in the financial position of PSPS and SASPS to the UK with-profits fund as described above.

	Assumption applied		Sensitivity change in assumption	Impact of sensitivity on scheme liabilities on IAS 19 basis		
	2018	**2017**			**2018**	**2017**
Discount rate	**2.8%**	2.5%	**Decrease by 0.2%**	**Increase in scheme liabilities by:**		
				PSPS	**3.5%**	3.5%
				Other schemes	**5.0%**	5.4%
Discount rate	**2.8%**	2.5%	**Increase by 0.2%**	**Decrease in scheme liabilities by:**		
				PSPS	**3.3%**	3.4%
				Other schemes	**4.7%**	4.9%
Rate of inflation	**3.3%**	3.1%	**RPI: Decrease by 0.2%**	**Decrease in scheme liabilities by:**		
	2.3%	2.1%	**CPI: Decrease by 0.2%**	**PSPS**	**0.6%**	0.6%
			with consequent reduction in salary increases	**Other schemes**	**3.9%**	3.9%
Mortality rate			**Increase life expectancy by 1 year**	**Increase in scheme liabilities by:**		
				PSPS	**3.9%**	4.0%
				Other schemes	**3.9%**	3.8%

C10 Share capital, share premium and own shares

Issued shares of 5p each fully paid	2018 Number of ordinary shares	2018 Share capital £m	2018 Share premium £m	2017 Number of ordinary shares	2017 Share capital £m	2017 Share premium £m
At 1 January	**2,587,175,445**	**129**	**1,948**	2,581,061,573	129	1,927
Shares issued under share-based schemes	**5,868,964**	**1**	**16**	6,113,872	–	21
At 31 December	**2,593,044,409**	**130**	**1,964**	2,587,175,445	129	1,948

Amounts recorded in share capital represent the nominal value of the shares issued. The difference between the proceeds received on issue of shares, net of issue costs, and the nominal value of shares issued is credited to the share premium account.

At 31 December 2018, there were options outstanding under save as you earn schemes to subscribe for shares as follows:

	Number of shares to subscribe for	Share price range from	Share price range to	Exercisable by year
31 Dec 2018	**4,885,804**	**901p**	**1,455p**	**2024**
31 Dec 2017	6,448,853	629p	1,455p	2023

Transactions by Prudential plc and its subsidiaries in Prudential plc shares
The Group buys and sells Prudential plc shares ('own shares') either in relation to its employee share schemes or via transactions undertaken by authorised investment funds that the Group is deemed to control. The cost of own shares of £170 million as at 31 December 2018 (31 December 2017: £250 million) is deducted from retained earnings. The Company has established trusts to facilitate the delivery of shares under employee incentive plans. At 31 December 2018, 9.6 million (31 December 2017: 11.4 million) Prudential plc shares with a market value of £135 million (31 December 2017: £218 million) were held in such trusts all of which are for employee incentive plans. The maximum number of shares held during 2018 was 14.9 million which was in March 2018.

The Company purchased the following number of shares in respect of employee incentive plans. The shares purchased each month are as follows:

	2018 Number of shares	2018 share price Low £	2018 share price High £	2018 Cost £	2017 Number of shares	2017 share price Low £	2017 share price High £	2017 Cost £
January	**51,555**	**19.18**	**19.40**	**996,536**	62,388	15.83	16.02	989,583
February	**55,765**	**17.91**	**18.10**	**1,004,362**	65,706	15.70	16.09	1,052,657
March	**55,623**	**18.25**	**18.54**	**1,025,238**	70,139	16.40	16.54	1,159,950
April	**1,664,334**	**16.67**	**17.95**	**29,113,556**	3,090,167	16.58	16.80	51,369,760
May	**63,334**	**18.91**	**19.38**	**1,216,136**	55,744	17.50	17.62	979,645
June	**181,995**	**18.21**	**18.65**	**3,335,725**	182,780	17.52	18.00	3,269,447
July	**55,888**	**17.68**	**17.86**	**993,779**	51,984	17.72	17.93	927,452
August	**60,384**	**18.04**	**18.10**	**1,090,283**	55,857	18.30	18.73	1,025,802
September	**82,612**	**16.95**	**16.98**	**1,400,868**	51,226	17.45	17.97	912,151
October	**148,209**	**15.62**	**16.84**	**2,477,127**	136,563	17.99	18.22	2,483,879
November	**67,162**	**15.95**	**15.96**	**1,071,633**	53,951	18.38	18.40	992,123
December	**73,744**	**13.99**	**14.30**	**1,045,278**	53,519	18.26	18.47	986,000
Total	**2,560,605**			**44,770,521**	3,930,024			66,148,449

The Group has consolidated a number of authorised investment funds where it is deemed to control these funds under IFRS. Some of these funds hold shares in Prudential plc. The total number of shares held by these funds at 31 December 2018 was 3.0 million (31 December 2017: 6.4 million) and the cost of acquiring these shares of £20 million (2017: £71 million) is included in the cost of own shares. The market value of these shares as at 31 December 2018 was £42 million (31 December 2017: £121 million). During 2018, these funds made net disposals of 3,368,506 Prudential shares (2017: acquisitions of 372,029) for a net decrease of £50.5 million to book cost (2017: net increase of £9.4 million).

All share transactions were made on an exchange other than the Stock Exchange of Hong Kong.

Other than set out above the Group did not purchase, sell or redeem any Prudential plc listed securities during 2018 or 2017.

D Other notes

D1 Corporate transactions

D1.1 Gains/(losses) on disposal of businesses and corporate transactions

'(Loss) gain on disposal of businesses and corporate transactions' comprises the following:

	2018 £m	2017 £m
Loss arising on reinsurance of part of UK shareholder-backed annuity portfolio[note (i)]	**(508)**	–
Other transactions[note (ii)]	**(80)**	223
	(588)	223

Notes
(i) Loss arising on reinsurance of part of UK shareholder-backed annuity portfolio
In March 2018, M&GPrudential announced the reinsurance of £12.0 billion (as at 31 December 2017) of its shareholder-backed annuity portfolio to Rothesay Life. Under the terms of the agreement, M&GPrudential has reinsured the liabilities to Rothesay Life, which is expected to be followed by a court sanctioned legal transfer, under Part VII of the Financial Services and Markets Act 2000 (Part VII), of most of the portfolio to Rothesay Life by 30 June 2019.

The reinsurance agreement became effective on 14 March 2018. A reinsurance premium of £12,149 million has been recognised within 'Outward reinsurance premiums' in the income statement and settled via the transfer of financial investments and other assets to Rothesay Life. After allowing for the recognition of a reinsurance asset and associated changes to policyholder liabilities, a loss of £(508) million was recognised in 2018 in relation to the transaction.

The reinsured annuity business that will be transferred once the Part VII process is complete has been classified as held for sale in these consolidated financial statements in accordance with IFRS 5, 'Non-current assets held for sale and discontinued operations'.

The assets and liabilities of the M&GPrudential annuity business classified as held for sale on the statement of financial position are as follows:

	31 Dec 2018 £m
Assets	
Reinsurer's share of insurance contract liabilities	**10,502**
Other assets (including cash and cash equivalents)	**66**
Assets held for sale	**10,568**
Liabilities	
Policyholder liabilities	**10,502**
Other liabilities	**66**
Liabilities held for sale	**10,568**

(ii) Other transactions
Other transaction costs of £80 million incurred by the Group in 2018 primarily relate to additional costs incurred in exiting from the NPH broker-dealer business and costs related to preparation for the previously announced intention to demerge M&GPrudential from Prudential plc, resulting in two separately listed entities.

In 2017, the Group completed its disposal of its Korea life business, realising a gain of £61 million principally as a result of recycling from other comprehensive income cumulative exchange gains of this business. On 15 August 2017, the Group, through its subsidiary National Planning Holdings, Inc. (NPH) sold its US independent broker-dealer network to LPL Financial LLC which realised a gain of £162 million in 2017. Together these two transactions generated a gain on disposal of businesses and corporate transactions of £223 million.

D1.2 Acquisition of TMB Asset Management Co., Ltd. in Thailand

In September 2018, the Group completed its initial acquisition of 65 per cent of TMB Asset Management Co,. Ltd. (TMBAM), an asset management company in Thailand, from TMB Bank Public Limited (TMB) for £197 million.

The terms of the sale agreement include a call option exercisable (by the Group) after three years and a put option exercisable (by TMB) after four years which, if exercised, triggers the purchase of the remaining 35 per cent of the business. The put option, in line with IFRS, has been recognised as a financial liability and a reduction in shareholders' equity of £106 million as of the acquisition date, being the discounted expected consideration payable for the remaining 35 per cent (£109 million as of 31 December 2018).

The fair value of the acquired assets, assumed liabilities and resulting goodwill are shown in the table below:

	31 Dec 2018 £m
Assets	
Intangible assets	**5**
Other assets	**26**
Cash and cash equivalents	**2**
Total assets	**33**
Other liabilities	**(10)**
Non-controlling interests	**(7)**
Net assets acquired and liabilities assumed	**16**
Goodwill arising on acquisition*	**181**
Purchase consideration	**197**

* The goodwill on acquisition of £181 million (retranslated to £186 million at 31 December 2018) is mainly attributable to the expected benefits from new customers and synergies. Refer to note C5.1 for changes to the carrying amount of goodwill during the year.

The acquisition of TMBAM contributed £18 million to revenue and £5 million to adjusted IFRS operating profit based on longer-term investment returns and profit before tax of the Group for the post-acquisition period from 27 September to 31 December 2018. There is no material impact on the Group's revenue and profit for 2018 if the acquisition had occurred on 1 January 2018.

D2 Contingencies and related obligations

Litigation and regulatory matters

In addition to the matters set out in note B3(iii) in relation to the Financial Conduct Authority review of past annuity sales, the Group is involved in various litigation and regulatory issues. These may from time to time include class actions involving Jackson. While the outcome of such litigation and regulatory issues cannot be predicted with certainty, the Company believes that their ultimate outcome will not have a material adverse effect on the Group's financial condition, results of operations, or cash flows.

D3 Post balance sheet events

Dividends

The second interim ordinary dividend for the year ended 31 December 2018, that was approved by the Board of Directors after 31 December 2018, is described in note B6.

Renewal of strategic bancassurance alliance with United Overseas Bank Limited

In January 2019, the Group announced the renewal of its regional strategic bancassurance alliance with United Overseas Bank Limited (UOB). The new agreement extends the original alliance, which commenced in 2010 to 2034 and increases the geographical scope to include a fifth market, Vietnam, alongside the existing markets across Singapore, Malaysia, Thailand and Indonesia.

As part of this transaction, Prudential has agreed to pay UOB an initial fee of £662 million (translated using a Singapore dollar: £ foreign exchange rate of 1.7360) for distribution rights which is not dependent on future sales volumes. This amount will be paid in three instalments of £230 million in February 2019, £331 million in January 2020 and £101 million in January 2021. In line with the Group's policy, these amounts will be capitalised as a distribution rights intangible asset.

Additional Unaudited Financial Information

I IFRS profit and loss

I(a) Analysis of long-term insurance business adjusted IFRS operating profit based on longer-term investment returns by driver

This schedule classifies the Group's adjusted IFRS operating profit based on longer-term investment returns from long-term insurance operations into the underlying drivers, using the following categories:

– **Spread income** represents the difference between net investment income and amounts credited to certain policyholder accounts. It excludes the operating investment return on shareholder net assets, which has been separately disclosed as expected return on shareholder assets.

– **Fee income** represents profits driven by net investment performance, being asset management fees that vary with the size of the underlying policyholder funds net of investment management expenses.

– **With-profits** represent the pre-tax shareholders' transfer from the with-profits funds for the year.

– **Insurance margin** primarily represents profits derived from the insurance risks of mortality and morbidity.

– **Margin on revenues** primarily represents amounts deducted from premiums to cover acquisition costs and administration expenses.

– **Acquisition costs and administration expenses** represent expenses incurred in the year attributable to shareholders. These exclude items such as restructuring costs which are not included in the segment profit for insurance, as well as items that are more appropriately included in other sources of earnings lines (eg investment expenses are netted against investment income as part of spread income or fee income as appropriate).

– **DAC adjustments** comprise DAC amortisation for the year, excluding amounts related to short-term fluctuations in investment returns, net of costs deferred in respect of new business.

Analysis of adjusted IFRS operating profit based on longer-term investment returns by source and margin analysis of Group long-term insurance business

The following analysis expresses certain of the Group's sources of adjusted IFRS operating profit based on long-term investment returns as a margin of policyholder liabilities or other relevant drivers. Details on the calculation of the Group's average policyholder liability balances are given in note (iv) at the end of this section.

	2018					
	Asia £m	US £m	UK and Europe £m	Total £m	Average liability £m note (iv)	Margin bps note (ii)
Spread income	**232**	**583**	**84**	**899**	**85,850**	**105**
Fee income	**210**	**2,445**	**56**	**2,711**	**175,443**	**155**
With-profits	**71**	**–**	**320**	**391**	**147,318**	**27**
Insurance margin	**1,481**	**949**	**50**	**2,480**		
Margin on revenues	**2,105**	**–**	**149**	**2,254**		
Expenses:						
Acquisition costs note (i)	**(1,503)**	**(759)**	**(57)**	**(2,319)**	**6,802**	**(34)%**
Administration expenses	**(1,029)**	**(1,204)**	**(180)**	**(2,413)**	**265,597**	**(91)**
DAC adjustments note (v)	**326**	**(114)**	**4**	**216**		
Expected return on shareholder assets	**129**	**11**	**102**	**242**		
	2,022	**1,911**	**528**	**4,461**		
Share of related tax charges from joint ventures and associate note (vi)	**(40)**		**–**	**(40)**		
Longevity reinsurance and other management actions to improve solvency			**58**	**58**		
Changes in longevity assumption basis			**441**	**441**		
Provision for guaranteed minimum pension equalisation			**(55)**	**(55)**		
Insurance recoveries of costs associated with review of past annuity sales			**166**	**166**		
Long-term business adjusted IFRS operating profit based on longer-term investment returns	**1,982**	**1,911**	**1,138**	**5,031**		

	2017 AER					
	Asia £m	**US £m**	**UK and Europe £m**	**Total £m**	**Average liability £m** note (iv)	**Margin bps** note(ii)
Spread income	234	751	137	1,122	88,908	126
Fee income	205	2,343	61	2,609	166,839	156
With-profits	59	–	288	347	136,474	25
Insurance margin	1,341	906	55	2,302		
Margin on revenues	2,098	–	189	2,287		
Expenses:						
Acquisition costs note (i)	(1,499)	(876)	(68)	(2,443)	6,958	(35)%
Administration expenses	(967)	(1,174)	(164)	(2,305)	261,114	(88)
DAC adjustments note (v)	241	260	4	505		
Expected return on shareholder assets	126	4	104	234		
	1,838	2,214	606	4,658		
Share of related tax charges from joint ventures and associate note (vi)	(39)	–	–	(39)		
Longevity reinsurance and other management actions to improve solvency	–	–	276	276		
Changes in longevity assumption basis	–	–	204	204		
Provision for review of past annuity sales	–	–	(225)	(225)		
Long-term business adjusted IFRS operating profit based on longer-term investment returns	1,799	2,214	861	4,874		

	2017 CER note (iii)					
	Asia £m	**US £m**	**UK and Europe £m**	**Total £m**	**Average liability £m** note (iv)	**Margin bps** note (ii)
Spread income	228	725	137	1,090	87,553	124
Fee income	195	2,262	61	2,518	162,267	155
With-profits	57	–	288	345	136,496	25
Insurance margin	1,293	875	55	2,223		
Margin on revenues	2,021	–	189	2,210		
Expenses:						
Acquisition costs note (i)	(1,450)	(846)	(68)	(2,364)	6,767	(35)%
Administration expenses	(933)	(1,134)	(164)	(2,231)	255,313	(87)
DAC adjustments note (v)	235	251	4	490		
Expected return on shareholder assets	120	4	104	228		
	1,766	2,137	606	4,509		
Share of related tax charges from joint ventures and associate note (vi)	(39)	–	–	(39)		
Longevity reinsurance and other management actions to improve solvency	–	–	276	276		
Changes in longevity assumption basis	–	–	204	204		
Provision for review of past annuity sales	–	–	(225)	(225)		
Long-term business adjusted IFRS operating profit based on longer-term investment returns	1,727	2,137	861	4,725		

Notes to sources of earnings tables throughout I(a)

(i) The ratio of acquisition costs is calculated as a percentage of APE sales including with-profits sales. Acquisition costs include only those relating to shareholder-backed business.

(ii) Margin represents the operating return earned in the year as a proportion of the relevant class of average policyholder liabilities excluding unallocated surplus.

(iii) The 2017 comparative information has been presented at AER and CER to eliminate the impact of foreign exchange translation. CER results are calculated by translating prior year results using the current year foreign exchange rates. All CER profit figures have been translated at current year average rates. For Asia CER average policyholder liability calculations, the amounts have been translated using current year opening and closing exchange rates. For the US CER average liability calculations, the amounts have been translated at the current year month-end closing exchange rates. See note A1 in the IFRS financial statements for foreign exchange rates used.

(iv) For UK and Europe and Asia, opening and closing policyholder liabilities have been used to derive an average balance for the year, as a proxy for average balances throughout the year. The calculation of average liabilities for Jackson is generally derived from month-end balances throughout the year, as opposed to opening and closing balances only. The average liabilities for fee income in Jackson have been calculated using daily balances instead of month-end balances in order to provide a more meaningful analysis of the fee income, which is charged on the daily account balance. Average liabilities for spread income are based on the general account liabilities to which spread income attaches. Average liabilities used to calculate the administration expense margin exclude the REALIC liabilities reinsured to third parties prior to the acquisition by Jackson.

(v) The DAC adjustments contain a credit of £55 million in respect of joint ventures and associate in 2018 (2017: AER credit of £43 million).

(vi) Under IFRS, the Group's share of results from its investments in joint ventures and associate accounted for using the equity method is included in the Group's profit before tax on a net of related tax basis. In 2018, the Group altered the presentation of its analysis of Asia adjusted IFRS operating profit based on longer-term investment returns by driver to show these tax charges separately in order for the contribution from the joint ventures and associate to be included in the margin analysis on a consistent basis as the rest of the Asia operations. 2017 comparatives have been re-presented accordingly.

Margin analysis of long-term insurance business – Asia

	2018			2017 AER			2017 CER note (iii)		
	Profit £m	**Average liability £m** note (iv)	**Margin bps** note (ii)	**Profit £m**	**Average liability £m** note (iv)	**Margin bps** note (ii)	**Profit £m**	**Average liability £m** note (iv)	**Margin bps** note (ii)
Spread income	**232**	**18,895**	**123**	234	16,359	143	228	16,351	139
Fee income	**210**	**20,105**	**104**	205	18,767	109	195	18,638	105
With-profits	**71**	**36,309**	**20**	59	30,115	20	57	30,137	19
Insurance margin	**1,481**			1,341			1,293		
Margin on revenues	**2,105**			2,098			2,021		
Expenses:									
Acquisition costs note (i)	**(1,503)**	**3,744**	**(40)%**	(1,499)	3,805	(39)%	(1,450)	3,671	(39)%
Administration expenses	**(1,029)**	**39,000**	**(264)**	(967)	35,126	(275)	(933)	34,989	(267)
DAC adjustments note (v)	**326**			241			235		
Expected return on shareholder assets	**129**			126			120		
	2,022			1,838			1,766		
Share of related tax charges from joint ventures and associate note (vi)	**(40)**			(39)			(39)		
Adjusted IFRS operating profit based on longer-term investment returns	**1,982**			1,799			1,727		

Analysis of Asia adjusted IFRS operating profit based on longer-term investment returns by driver:

— Spread income has increased on a CER basis by 2 per cent (AER: decreased by 1 per cent) to £232 million in 2018, with a decrease in the margin on a CER basis from 139 basis points in 2017 to 123 basis points in 2018 (AER: decreased from 143 basis points in 2017 to 123 basis points in 2018) predominantly reflecting the change in investment mix, country and product mix.

– Fee income has increased by 8 per cent on a CER basis (AER: 2 per cent) to £210 million in 2018, broadly in line with the increase in movement in average unit-linked policyholder liabilities.

– Insurance margin has increased by 15 per cent on a CER basis (AER: 10 per cent) to £1,481 million in 2018, primarily reflecting the continued growth of the in-force book, which contains a relatively high proportion of risk-based products.

– Margin on revenues has increased by 4 per cent on a CER basis (AER: less than one per cent) to £2,105 million in 2018, primarily reflecting higher premiums together with the effect of changes in product mix and higher premium allocation to policyholders.

– Acquisition costs have increased by 4 per cent on a CER basis (AER: less than one per cent) to £1,503 million in 2018, compared to a 2 per cent increase in APE sales on a CER basis, resulting in an increase in the acquisition costs ratio. The analysis in the table above uses shareholder acquisition costs as a proportion of total APE sales. If with-profits sales were excluded from the denominator, the acquisition cost ratio would become 69 per cent (2017: 67 per cent on a CER basis), the increase being the result of product and country mix.

– Administration expenses including renewal commissions have increased by 10 per cent on a CER basis (AER: 6 per cent) to £1,029 million in 2018 as the business continues to expand. On a CER basis, the administration expense ratio has decreased from 267 basis points in 2017 to 264 basis points in 2018 as a result of changes in country and product mix.

Margin analysis of long-term insurance business – US

	2018			2017 AER			2017 CER[note (iii)]		
	Profit £m	**Average liability £m** note (iv)	**Margin bps** note (ii)	**Profit £m**	**Average liability £m** note (iv)	**Margin bps** note (ii)	**Profit £m**	**Average liability £m** note (iv)	**Margin bps** note (ii)
Spread income	**583**	**37,608**	**155**	751	38,918	193	725	37,571	193
Fee income	**2,445**	**133,407**	**183**	2,343	125,440	187	2,262	120,997	187
Insurance margin	**949**			906			875		
Expenses									
Acquisition costs[note (i)]	**(759)**	**1,542**	**(49)%**	(876)	1,662	(53)%	(846)	1,605	(53)%
Administration expenses	**(1,204)**	**175,319**	**(69)**	(1,174)	169,725	(69)	(1,134)	164,061	(69)
DAC adjustments	**(114)**			260			251		
Expected return on shareholder assets	**11**			4			4		
Adjusted IFRS operating profit based on longer-term investment returns	**1,911**			2,214			2,137		

Analysis of US adjusted IFRS operating profit based on long-term investment returns by driver:

- Spread income has decreased by 20 per cent on a CER basis (AER: 22 per cent) to £583 million in 2018. The reported spread margin decreased to 155 basis points from 193 basis points in 2017, primarily due to the impact of increasing LIBOR on interest rate swaps, lower investment yields and maturing of swaps previously entered into to more closely match the asset and liability duration. Excluding the effect of these historic swap transactions, the spread margin would have been 130 basis points (2017: 144 basis points at CER and AER).
- Fee income has increased by 8 per cent on a CER basis (AER: 4 per cent) to £2,445 million during 2018, primarily due to higher average separate account balances resulting from positive net flows from variable annuity business and market appreciation during most of 2018 before a decline in the fourth quarter of 2018. Fee income margin has decreased to 183 basis points (2017:187 basis points at CER and AER) primarily reflecting a change in business mix.
- Insurance margin represents profits from insurance risks, including variable annuity guarantees and other sundry items. Insurance margin increased by 8 per cent on a CER basis (AER: 5 per cent) to £949 million in 2018 mainly due to higher income from variable annuity guarantees and favourable mortality experience.
- Acquisition costs, which are commissions and expenses incurred to acquire new business, including those that are not deferrable, have decreased by 10 per cent on a CER basis (AER: 13 per cent). This reflects a 4 per cent decrease in APE sales and lower level of front-ended commissions.
- Administration expenses increased by 6 per cent on a CER basis (AER: 3 per cent) to £(1,204) million during 2018, primarily as a result of higher asset-based commissions. Excluding these asset-based commissions, the resulting administration expense ratio would be lower at 34 basis points (2017: 35 basis points at CER and AER).
- DAC adjustments in 2018 was negative £(114) million (compared to £251 million credit in 2017 on a CER basis) due to an increase in the DAC amortisation charge. The higher DAC amortisation charge arises largely from an acceleration of amortisation of £(194) million (2017: credit for deceleration of £83 million on a CER basis) primarily relating to the market returns in 2018 and the reversal of the benefit received in 2015 under the mean reversion formula.

Analysis of adjusted IFRS operating profit based on longer-term investment returns before and after acquisition costs and DAC adjustments

	2018 £m				2017 AER £m				2017 CER[note (iii)] £m			
		Acquisition costs				Acquisition costs				Acquisition costs		
	Before acquisition costs and DAC adjustments	Incurred	Deferred	After acquisition costs and DAC adjustments	Before acquisition costs and DAC adjustments	Incurred	Deferred	After acquisition costs and DAC adjustments	Before acquisition costs and DAC adjustments	Incurred	Deferred	After acquisition costs and DAC adjustments
Total adjusted IFRS operating profit based on longer-term investment returns before acquisition costs and DAC adjustments	**2,784**			**2,784**	2,830			2,830	2,732			2,732
Less new business strain		**(759)**	**569**	**(190)**		(876)	663	(213)		(846)	640	(206)
Amortisation of previously deferred acquisition costs:												
Normal			**(489)**	**(489)**			(489)	(489)			(472)	(472)
(Accelerated)decelerated			**(194)**	**(194)**			86	86			83	83
Total	**2,784**	**(759)**	**(114)**	**1,911**	2,830	(876)	260	2,214	2,732	(846)	251	2,137

Analysis of adjusted IFRS operating profit based on longer-term investment returns for US operations by product

	2018 £m	2017 £m		2018 vs 2017 %	
		AER	CER	AER	CER
Spread business	**297**	317	306	(6)%	(3)%
Fee business	**1,532**	1,788	1,726	(14)%	(11)%
Life and other business	**82**	109	105	(25)%	(22)%
Total insurance operations[note]	**1,911**	2,214	2,137	(14)%	(11)%
US asset management and broker-dealer	**8**	10	9	(20)%	(11)%
Total US operations	**1,919**	2,224	2,146	(14)%	(11)%

Note

The analysis of adjusted IFRS operating profit based on longer-term investment returns for US operations by product represents the net profit generated by each line of business after allocation of costs. Broadly:

– Spread business is the net profit for fixed annuity, fixed indexed annuity and guaranteed investment contracts and largely comprises spread income less costs.
– Fee business represents profits from variable annuity products. As well as fee income, revenue for this product line includes spread income from investments directed to the general account and other variable annuity fees included in insurance margin.
– Life and other business includes the profits from the REALIC business and other closed life books. Revenue allocated to this product line includes spread income and premiums and policy charges for life protection, which are included in insurance margin after claim costs. Insurance margin forms the vast majority of revenue.

Margin analysis of long-term insurance business – UK and Europe

	2018			2017		
	Profit £m	**Average liability £m** note (iv)	**Margin bps** note (ii)	**Profit £m**	**Average liability £m** note (iv)	**Margin bps** note (ii)
Spread income	**84**	**29,347**	**29**	137	33,631	41
Fee income	**56**	**21,931**	**26**	61	22,632	27
With-profits	**320**	**111,009**	**29**	288	106,359	27
Insurance margin	**50**			55		
Margin on revenues	**149**			189		
Expenses:						
Acquisition costs[note (i)]	**(57)**	**1,516**	**(4)%**	(68)	1,491	(5)%
Administration expenses	**(180)**	**51,278**	**(35)**	(164)	56,263	(29)
DAC adjustments	**4**			4		
Expected return on shareholder assets	**102**			104		
	528			606		
Longevity reinsurance and other management actions to improve solvency	**58**			276		
Changes in longevity assumption basis	**441**			204		
Provision for guaranteed minimum pension equalisation	**(55)**			-		
Insurance recoveries of costs associated with review of past annuity sales	**166**			-		
Provision for review of past annuity sales	**-**			(225)		
Adjusted IFRS operating profit based on longer-term investment returns	**1,138**			861		

Analysis of UK and Europe adjusted IFRS operating profit based on longer-term investment returns by driver:

- Spread income has reduced from £137 million in 2017 to £84 million in 2018 reflecting the run-off of the in-force annuity portfolio and the effect of the reinsurance of £12.0 billion of annuity portfolios to Rothesay Life entered into in March 2018.
- Fee income principally represents asset management fees from unit-linked business (including direct investment only business to Group pension schemes where liability flows are driven by a small number of large single mandate transactions and mostly arises within the UK and Europe asset management business). Fee income is after costs relating to managing the underlying funds which include recent rationalisation activity to remove sub-scale funds. If these costs and the direct investment only schemes are excluded, the fee margin on the remaining balances would be 36 basis points (2017: 40 basis points).
- Margin on revenues represents premium charges for expenses of shareholder-backed business and other sundry net income.
- The £441 million favourable effect of longevity assumption relates to changes to annuitant mortality assumptions to reflect current mortality experience and the adoption of the Continuous Mortality Investigation (CMI) 2016 model. Further information on changes to mortality assumptions is given in note C4.1(d) in the IFRS financial statements.
- An allowance provision of £(55) million has been made in 2018 to reflect the costs of equalising guaranteed minimum pension benefits on pension products sold by the insurance business following the ruling by the High Court in October 2018. Further information is provided in note C9 in the IFRS financial statements.
- The 2018 insurance recoveries of costs associated with undertaking a review of past annuity sales of £166 million (2017: nil) is explained in note B4(b) in the IFRS financial statements.

I(b) Asia operations – analysis of IFRS operating profit by business unit

Operating profit based on longer-term investment returns for Asia operations is analysed as follows:

	2018 £m	AER 2017 £m	CER 2017 £m	2017 AER vs 2018	2017 CER vs 2018
Hong Kong	**443**	346	332	28%	33%
Indonesia	**416**	457	415	(9)%	0%
Malaysia	**194**	173	178	12%	9%
Philippines	**43**	41	38	5%	13%
Singapore	**329**	272	269	21%	22%
Thailand	**113**	107	108	6%	5%
Vietnam	**149**	135	129	10%	16%
South-east Asia operations including Hong Kong	**1,687**	1,531	1,469	10%	15%
China	**143**	121	119	18%	20%
Taiwan	**51**	43	41	19%	24%
Other	**51**	71	67	(28)%	(24)%
Non-recurrent items[note]	**94**	75	73	25%	29%
Total insurance operations	**2,026**	1,841	1,769	10%	15%
Share of related tax charges from joint ventures and associate*	**(40)**	(39)	(39)	(3)%	(3)%
Development expenses	**(4)**	(3)	(3)	(33)%	(33)%
Total long-term business operating profit	**1,982**	1,799	1,727	10%	15%
Asset management (Eastspring Investments)	**182**	176	171	3%	6%
Total Asia operations	**2,164**	1,975	1,898	10%	14%

* Under IFRS, the Group's share of results from its investments in joint ventures and associate accounted for using the equity method is included in the Group's profit before tax on a net of related tax basis. In 2018, the Group altered the presentation of its analysis of Asia operating profit to show these tax charges separately in order for the contribution from the joint ventures and associate to be included in the operating profit analysis on a consistent basis as the rest of the Asia's operations. 2017 comparatives have been re-presented accordingly.

Note

In 2018, the IFRS operating profit based on longer-term investment returns for Asia insurance operations included a net credit of £94 million (2017: £75 million) representing a small number of items that are not expected to reoccur, including the impact of a refinement to the run-off of the allowance for prudence within technical provisions, within Singapore.

I(c) Analysis of asset management operating profit based on longer-term investment returns

	2018 £m	
	M&GPrudential asset management note (ii)	**Eastspring Investments** note (ii)
Operating income before performance-related fees	**1,100**	**424**
Performance-related fees	**15**	**17**
Operating income (net of commission)[note (i)]	**1,115**	**441**
Operating expense[note (i)]	**(654)**	**(232)**
Share of associate's results	**16**	**–**
Group's share of tax on joint ventures' operating profit	**–**	**(27)**
Operating profit based on longer-term investment returns	**477**	**182**
Average funds under management	**£276.6bn**	**£146.3bn**
Margin based on operating income*	**40bps**	**29bps**
Cost/income ratio†	**59%**	**55%**

	2017 £m	
	M&GPrudential asset management note (ii)	**Eastspring Investments** note (ii)
Operating income before performance-related fees	1,034	421
Performance-related fees	53	17
Operating income (net of commission)[note (i)]	1,087	438
Operating expense[note (i)]	(602)	(238)
Share of associate's results	15	–
Group's share of tax on joint ventures' operating profit	–	(24)
Operating profit based on longer-term investment returns	500	176
Average funds under management	£275.9bn	£128.4bn
Margin based on operating income*	37bps	33bps
Cost/income ratio†	58%	56%

* Margin represents operating income before performance-related fees as a proportion of the related funds under management (FUM). Monthly closing internal and external funds managed by the respective entity have been used to derive the average. Any funds held by the Group's insurance operations that are managed by third parties outside the Prudential Group are excluded from these amounts. M&GPrudential operating expense includes £27 million of Brexit preparation costs.

† Cost/income ratio represents cost as a percentage of operating income before performance-related fees.

Notes

(i) Operating income and expense include the Group's pre-tax share of contribution from joint ventures but excludes any contribution from associate. In the consolidated income statement of the IFRS financial statements, the net post-tax income of the joint ventures and associate is shown as a single line item.

(ii) Operating income before performance related fees and margin on related funds under management for M&GPrudential asset management and Eastspring Investments can be further analysed as follows:

	M&GPrudential asset management					
	Operating income before performance related fees					
	Retail £m	**Margin bps**	**Institutional* £m**	**Margin bps**	**Total £m**	**Margin bps**
2018	**662**	**85**	**438**	**22**	**1,100**	**40**
2017	604	85	430	21	1,034	37

	Eastspring Investments					
	Operating income before performance related fees					
	Retail £m	**Margin bps**	**Institutional* £m**	**Margin bps**	**Total £m**	**Margin bps**
2018	**252**	**50**	**172**	**18**	**424**	**29**
2017	249	57	172	20	421	33

* Institutional includes internal funds.

I(d) Contribution to UK long-term financial metrics from specific management actions undertaken to position the balance sheet more efficiently under the Solvency II regime

In 2018, further management actions were taken to improve the solvency of the UK and Europe insurance operations and to mitigate market risks. These actions included repositioning the fixed income asset portfolio to improve the trade-off between yield and credit risk. No new longevity reinsurance transactions were undertaken in 2018 (2017: longevity reinsurance transactions entered into covering £0.5 billion of IFRS annuity liabilities).

The effect of these actions on the UK's long-term IFRS operating profit, underlying free surplus generation and EEV operating profit, before restructuring costs, is shown in the tables below.

IFRS operating profit of UK long-term business before tax

	2018 £m	2017 £m
Shareholder-backed annuity new business	**9**	9
In-force business:		
Longevity reinsurance transactions	**–**	31
Other management actions to improve solvency	**58**	245
Changes in longevity assumption basis	**441**	204
Provision for the review of past annuity sales	**–**	(225)
Insurance recoveries in respect of above costs	**166**	–
Provision for guaranteed minimum pension equalisation	**(55)**	–
	610	255
With-profits and other in-force	**519**	597
Total IFRS operating profit before restructuring costs	**1,138**	861

Underlying free surplus generation of UK long-term business

	2018 £m	2017 £m
Expected in-force and return on net worth	**686**	706
Longevity reinsurance transactions	**–**	15
Other management actions to improve solvency	**54**	385
Changes in longevity assumption basis	**364**	179
Provision for the review of past annuity sales	**–**	(187)
Insurance recoveries in respect of above costs	**138**	–
Provision for guaranteed minimum pension equalisation	**(95)**	–
	461	392
Other in-force	**130**	(28)
Underlying free surplus generated from in-force business	**1,277**	1,070
New business strain	**(102)**	(175)
Total free surplus generation before restructuring costs	**1,175**	895

EEV post-tax operating profit of UK long-term business

	2018 £m	2017 £m
Unwind of discount and other expected return	**474**	465
Longevity reinsurance transactions	**–**	(6)
Other management actions to improve solvency	**141**	127
Changes in longevity assumption basis	**330**	195
Provision for the review of past annuity sales	**–**	(187)
Insurance recoveries in respect of above costs	**138**	–
Provision for guaranteed minimum pension equalisation	**(48)**	–
	561	129
Other in-force	**(13)**	79
Operating profit from in-force business	**1,022**	673
New business profit	**352**	342
Total EEV operating profit before restructuring costs	**1,374**	1,015

II Other information

II(a) Holding company cash flow*

	2018 £m	2017 £m
Net cash remitted by business units:		
Asia	**699**	645
US	**342**	475
UK and Europe:		
With-profits remittance	**233**	215
Shareholder-backed insurance business remittance	**97**	105
Asset management remittance	**324**	323
	654	643
Other UK paid to the Group (including Prudential Capital)	**37**	25
Total UK net remittances to the Group	**691**	668
Net remittances to the Group from business units note (i)	**1,732**	1,788
Net interest paid	**(366)**	(415)
Tax received	**142**	152
Corporate activities	**(206)**	(207)
Total central outflows	**(430)**	(470)
Operating holding company cash flow before dividend	**1,302**	1,318
Dividend paid	**(1,244)**	(1,159)
Operating holding company cash flow after dividend	**58**	159
Non-operating net cash flow note (ii)	**913**	(511)
Total holding company cash flow	**971**	(352)
Cash and short-term investments at beginning of year	**2,264**	2,626
Foreign exchange movements	**1**	(10)
Cash and short-term investments at end of year note (iii)	**3,236**	2,264

* The holding company cash flow differs from the IFRS cash flow statement, which includes all cash flows in the period including those relating to both policyholder and shareholder funds. The holding company cash flow is therefore a more meaningful indication of the Group's central liquidity.

Notes

(i) Net cash remittances comprise dividends and other transfers from business units that are reflective of emerging earnings and capital generation.

(ii) Non-operating net cash flow principally relates to the issue of subordinated debt less repayment of debt, and payments for distribution rights and acquisition of subsidiaries.

(iii) Including central finance subsidiaries.

II(b) Funds under management

(a) Summary

For our asset management businesses, funds managed on behalf of third parties are not recorded on the balance sheet. They are, however, a driver of profitability. We therefore analyse the movement in the funds under management each period, focusing on those which are external to the Group and those primarily held by the insurance businesses. The table below analyses, by segment, the funds of the Group held in the statement of financial position and the external funds that are managed by Prudential's asset management operations.

	31 Dec 2018 £bn	31 Dec 2017 £bn
Asia operations:		
Internal funds	**89.5**	81.4
Eastspring Investments' external funds	**61.1**	55.9
	150.6	137.3
US operations: internal funds	**183.1**	178.3
UK and Europe operations:		
Internal funds, including PruFund-backed products	**174.3**	186.8
External funds	**146.9**	163.9
	321.2	350.7
Other operations	**2.4**	3.0
Group total funds under management[note]	**657.3**	669.3

Note

Total funds under management comprise:

	31 Dec 2018 £bn	31 Dec 2017 £bn
Total investments per the consolidated statement of financial position	**449.6**	451.4
External funds of M&GPrudential and Eastspring Investments (as analysed in note (b) below)	**208.0**	219.8
Internally managed funds held in joint ventures and other adjustments	**(0.3)**	(1.9)
Group total funds under management	**657.3**	669.3

(b) Investment products – external funds under management

	2018 £m					2017 £m				
	At 1 Jan 2018	Market gross inflows	Redemptions	Market and other movements	At 31 Dec 2018	At 1 Jan 2017	Market gross inflows	Redemptions	Market and other movements	At 31 Dec 2017
M&GPrudential Wholesale/Direct	**79,697**	**24,584**	**(29,452)**	**(5,364)**	**69,465**	64,209	30,949	(19,906)	4,445	79,697
M&GPrudential Institutional	**84,158**	**12,954**	**(18,001)**	**(1,630)**	**77,481**	72,554	15,220	(8,926)	5,310	84,158
Total M&GPrudential[note (i)]	**163,855**	**37,538**	**(47,453)**	**(6,994)**	**146,946**	136,763	46,169	(28,832)	9,755	163,855
Eastspring Investments[note(ii)]	**55,885**	**212,070**	**(212,156)**	**5,258**	**61,057**	45,756	215,907	(211,271)	5,493	55,885
Total[note (iii)]	**219,740**	**249,608**	**(259,609)**	**(1,736)**	**208,003**	182,519	262,076	(240,103)	15,248	219,740

Notes

(i) The results exclude contribution from PruFund products: net inflows of £8.5 billion in 2018 (2017: £9.0 billion); funds under management of £43 billion as at 31 December 2018 (31 December 2017: £35.9 billion).

(ii) Market and other movements during the year for Eastspring investments include inflow of £9.3 billion funds under management from acquisition of TMB Asset Management Co., Ltd. ('TMBAM') in Thailand. See note D1.2 of the consolidated financial statements for further details.

(iii) The £208 billion (31 December 2017: £219.7 billion) investment products comprise £196.4 billion (31 December 2017: £210.4 billion) plus Asia Money Market Funds of £11.6 billion (31 December 2017: £9.3 billion).

(c) M&G and Eastspring Investments – total funds under management

M&G, the asset management business of M&GPrudential and Eastspring Investments, the Group's asset management business in Asia, manage funds from external parties and also funds for the Group's insurance operations. The table below analyses the total funds under management managed by M&G and Eastspring Investments respectively.

	M&G		Eastspring Investments	
	31 Dec 2018 £bn	31 Dec 2017 £bn	31 Dec 2018 £bn note	31 Dec 2017 £bn note
External funds under management	**146.9**	163.9	**61.1**	55.9
Internal funds under management	**118.2**	134.6	**90.2**	83.0
Total funds under management	**265.1**	298.5	**151.3**	138.9

Note

The external funds under management for Eastspring Investments include Asia Money Market Funds at 31 December 2018 of £11.6 billion (31 December 2017: £9.3 billion).

II(c) Solvency II capital position

The estimated Group shareholder Solvency II surplus at 31 December 2018 was £17.2 billion, before allowing for payment of the 2018 second interim ordinary dividend and reflecting approved regulatory transitional measures as at 31 December 2018.

Estimated Group shareholder Solvency II capital position*	31 Dec 2018	31 Dec 2017
Own Funds(£bn)	**30.2**	26.4
Solvency Capital Requirement (£bn)	**13.0**	13.1
Surplus (£bn)	**17.2**	13.3
Solvency ratio (%)	**232%**	202%

* The Group shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring fenced with-profit funds and staff pension schemes in surplus. The estimated solvency positions include management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date, which for both 2018 and 2017 reflects the approved regulatory position.

In accordance with Solvency II requirements, these results allow for:

- Capital in Jackson in excess of 250 per cent of the US local Risk Based Capital requirement. As agreed with the Prudential Regulation Authority, this is incorporated in the result above as follows:
  - Own funds: represents Jackson's local US Risk Based available capital less 100 per cent of the US Risk Based Capital requirement (Company Action Level);
  - Solvency Capital Requirement: represents 150 per cent of Jackson's local US Risk Based Capital requirement (Company Action Level); and
  - No diversification benefits are taken into account between Jackson and the rest of the Group.
- Matching adjustment for UK annuities and volatility adjustment for US dollar denominated Hong Kong with-profits business, based on approvals from the Prudential Regulation Authority and calibrations published by the European Insurance and Occupational Pensions Authority; and
- UK transitional measures, which have been recalculated using management's estimate of the impact of operating and market conditions at the valuation date. An application to recalculate the transitional measures as at 31 December 2018 has been approved by the Prudential Regulation Authority and this recalculation will therefore be reflected in the formal regulatory Quantitative Reporting Templates as at 31 December 2018.

The Group shareholder Solvency II capital position excludes:

- A portion of Solvency II surplus capital (£1.7 billion at 31 December 2018) relating to the Group's Asian life operations, primarily due to the Solvency II definition of 'contract boundaries' which prevents some expected future cash flows from being recognised;
- The contribution to Own Funds and the Solvency Capital Requirement from ring-fenced with-profits funds in surplus (representing £5.5 billion of surplus capital from UK with-profits funds at 31 December 2018) and from the shareholders' share of the estate of with-profits funds; and
- The contribution to Own Funds and the Solvency Capital Requirement from pension funds in surplus.

It also excludes unrealised gains on certain derivative instruments taken out to protect Jackson against declines in long-term interest rates. At Jackson's request, the Department of Insurance Financial Services renewed its approval to carry these instruments at book value in the local statutory returns for the period 31 December 2018 to 1 October 2019. At 31 December 2018, applying this approval had the effect of decreasing local available statutory capital and surplus (and by extension Solvency II Own Funds and Solvency II surplus) by £0.1 billion, net of tax. This arrangement reflects an elective long-standing practice first put in place in 2009, which can be unwound at Jackson's discretion.

The 31 December 2018 Solvency II results above allow for the reinsurance of £12.0 billion of the UK annuity portfolio to Rothesay Life effective from 14 March 2018 and the transfer of Prudential plc's Hong Kong subsidiaries to Prudential Corporation Asia Limited. In total these items have resulted in a decrease to UK Solvency II surplus in 2018 of £3.3 billion with Group Solvency II surplus increasing by £0.4 billion.

Analysis of movement in Group capital position

A summary of the estimated movement in Group Solvency II surplus from £13.3 billion at year end 2017 to £17.2 billion at year end 2018 is set out in the table below. The movement from the Group Solvency II surplus at 31 December 2016 to the Solvency II surplus at 31 December 2017 is included for comparison.

Analysis of movement in Group shareholder surplus	2018 Surplus £bn	2017 Surplus £bn
Estimated Solvency II surplus at beginning of year	**13.3**	12.5
Underlying operating experience	**4.1**	3.2
Management actions	**0.1**	0.4
Operating experience	**4.2**	3.6
Non-operating experience (including market movements)	**(1.2)**	(0.6)
M&GPrudential transactions	**0.4**	–
Other capital movements:		
Net subordinated debt issuance/redemption	**1.2**	(0.2)
Foreign currency translation impacts	**0.5**	(0.7)
Dividends paid	**(1.2)**	(1.2)
Model changes	**0.0**	(0.1)
Estimated Solvency II surplus at end of year	**17.2**	13.3

The estimated movement in Group Solvency II surplus over 2018 is driven by:

- *Operating experience of £4.2 billion:* generated by in-force business and new business written in 2018, after allowing for amortisation of the UK transitional measures and the impact of one-off management optimisations implemented over the year. This includes a £0.4 billion benefit from the impact of updates to UK longevity best estimate assumptions and a £0.1 billion benefit from an insurance recovery relating to the costs and any related redress of reviewing internally vesting annuities sold without advice after 1 July 2008;
- *Non-operating experience of £(1.2) billion*: resulting mainly from the negative impact of market movements, after allowing for the recalculation of the UK transitional measures at the valuation date, the impact of US Risk Based Capital updates announced in June 2018 to reflect US tax reform changes and the £(0.3) billion impact from the acquisition of TMB Asset Management Co., Ltd. (see IFRS Financial Statements note D1.2 for further information);
- *M&GPrudential transactions of £0.4 billion*: the beneficial impact on the Group Solvency II surplus of the UK annuities reinsurance transaction effective from 14 March 2018 and the transfer of Prudential plc's Hong Kong subsidiaries to Prudential Corporation Asia Limited after allowing for the impact of recalculation of the UK transitional measures as a result of these transactions;
- *Other capital movements:* comprising an increase in surplus from the net impact of debt raised offset by debt redeemed during 2018, a benefit from foreign currency translation and a reduction in surplus from payment of dividends; and
- *Model changes:* reflecting internal model changes approved by the Prudential Regulation Authority and other minor internal model calibration changes made in 2018.

Analysis of Group Solvency Capital Requirements

The split of the Group's estimated Solvency Capital Requirement by risk type including the capital requirements in respect of Jackson's risk exposures based on 150 per cent of US Risk Based Capital requirements (Company Action Level) but with no diversification between Jackson and the rest of the Group, is as follows:

	31 Dec 2018		31 Dec 2017	
Split of the Group's estimated Solvency Capital Requirements	% of undiversified Solvency Capital Requirements	% of diversified Solvency Capital Requirements	% of undiversified Solvency Capital Requirements	% of diversified Solvency Capital Requirements
Market	**57%**	**70%**	57%	71%
Equity	**13%**	**23%**	14%	23%
Credit	**23%**	**38%**	24%	38%
Yields (interest rates)	**16%**	**6%**	13%	7%
Other	**5%**	**3%**	6%	3%
Insurance	**24%**	**20%**	26%	21%
Mortality/morbidity	**5%**	**2%**	5%	2%
Lapse	**15%**	**17%**	14%	17%
Longevity	**4%**	**1%**	7%	2%
Operational/expense	**12%**	**8%**	11%	7%
FX translation	**7%**	**2%**	6%	1%

Reconciliation of IFRS equity to Group Solvency II Shareholder Own Funds

Reconciliation of IFRS equity to Group Solvency II Shareholder Own Funds	31 Dec 2018 £bn	31 Dec 2017 £bn
IFRS shareholders' equity	**17.2**	16.1
Restate US insurance entities from IFRS to local US statutory basis	**(2.5)**	(3.0)
Remove DAC, goodwill and intangibles	**(4.6)**	(4.0)
Add subordinated debt	**7.2**	5.8
Impact of risk margin (net of transitional measures)	**(3.8)**	(3.9)
Add value of shareholder transfers	**5.3**	5.3
Liability valuation differences	**13.3**	12.1
Increase in net deferred tax liabilities resulting from liability valuation differences above	**(1.5)**	(1.6)
Other	**(0.4)**	(0.4)
Estimated Solvency II Shareholder Own Funds	**30.2**	26.4

The key items of the reconciliation as at 31 December 2018 are:

- £(2.5) billion represents the adjustment required to the Group's shareholders' funds in order to convert Jackson's contribution from an IFRS basis to the local statutory valuation basis. This item also reflects a de-recognition of Own Funds of £1.0 billion, equivalent to the value of 100 per cent of Risk Based Capital requirements (Company Action Level), as agreed with the Prudential Regulation Authority;
- £(4.6) billion due to the removal of DAC, goodwill and intangibles from the IFRS balance sheet;
- £7.2 billion due to the addition of subordinated debt which is treated as available capital under Solvency II but as a liability under IFRS;
- £(3.8) billion due to the inclusion of a risk margin for UK and Asia non-hedgeable risks, net of £1.6 billion from transitional measures (after allowing for recalculation of the transitional measures as at 31 December 2018) which are not applicable under IFRS;
- £5.3 billion due to the inclusion of the value of future shareholder transfers from with-profits business (excluding the shareholders' share of the with-profits estate, for which no credit is given under Solvency II), which is excluded from the determination of the Group's IFRS shareholders' funds;
- £13.3 billion mainly due to differences in insurance valuation requirements between Solvency II and IFRS, with Solvency II Own Funds partially capturing the value of in-force business which is excluded from IFRS;
- £(1.5) billion due to the impact on the valuation of net deferred tax liabilities resulting from the liability valuation differences noted above; and
- £(0.4) billion due to other items, including the impact of revaluing loans, borrowings and debt from IFRS to Solvency II.

Sensitivity analysis

The estimated sensitivity of the Group shareholder Solvency II capital position to significant changes in market conditions is as follows:

	31 Dec 2018		31 Dec 2017	
Impact of market sensitivities	**Surplus £bn**	**Ratio**	**Surplus £bn**	**Ratio**
Base position	**17.2**	**232%**	13.3	202%
Impact of:				
20% instantaneous fall in equity markets	**(1.6)**	**(10)%**	0.7	9%
40% fall in equity markets[1]	**(4.0)**	**(28)%**	(2.1)	(11)%
50 basis points reduction in interest rates[2,3]	**(1.8)**	**(21)%**	(1.0)	(14)%
100 basis points increase in interest rates[3]	**1.2**	**20%**	1.2	21%
100 basis points increase in credit spreads[4]	**(1.7)**	**(9)%**	(1.4)	(6)%

Notes

1 Where hedges are dynamic, rebalancing is allowed for by assuming an instantaneous 20 per cent fall followed by a further 20 per cent fall over a four-week period.
2 Subject to a floor of zero for Asia and US interest rates.
3 Allowing for further transitional measures recalculation after the interest rate stress.
4 US Risk Based Capital solvency position included using a stress of 10 times expected credit defaults.

The Group believes it is positioned to withstand significant deteriorations in market conditions and we continue to use market hedges to manage some of this exposure across the Group, where we believe the benefit of the protection outweighs the cost. The sensitivity analysis above allows for predetermined management actions and those taken to date, but does not reflect all possible management actions which could be taken in the future.

UK Solvency II capital position[1, 2]

On the same basis as above, the estimated shareholder Solvency II surplus for The Prudential Assurance Company Limited ('PAC') and its subsidiaries[2] at 31 December 2018 was £3.7 billion, after allowing for recalculation of transitional measures as at 31 December 2018. This relates to shareholder-backed business including future with-profits shareholder transfers, but excludes the shareholders' share of the estate in line with Solvency II requirements.

Estimated UK shareholder Solvency II capital position*	31 Dec 2018	31 Dec 2017
Own Funds (£bn)	**8.8**	14.0
Solvency Capital Requirement (£bn)	**5.1**	7.9
Surplus (£bn)	**3.7**	6.1
Solvency ratio (%)	**172%**	178%

* The UK shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring-fenced with-profit funds and staff pension schemes in surplus. The estimated solvency positions include management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date, which for both 2018 and 2017 reflects the approved regulatory position.

The Prudential Assurance Company Limited shareholder Solvency II position at 31 December 2018 includes the actual impact of the transfer of Prudential plc's Hong Kong subsidiaries to Prudential Corporation Asia Limited, and the impact of the reinsurance of £12.0 billion of the UK annuity portfolio to Rothesay Life. In total these items have resulted in a decrease to UK Solvency II surplus in 2018 of £3.3 billion.

Upon completion of the Part VII transfer a further circa £0.1 billion of Solvency Capital Requirement is expected to be released.

Whilst there is a large surplus in the UK with-profits funds, this is ring-fenced from the shareholder balance sheet and is therefore excluded from both the Group and the UK shareholder Solvency II surplus results. The estimated UK with-profits funds Solvency II surplus at 31 December 2018 was £5.5 billion, after allowing for recalculation of transitional measures as at 31 December 2018.

Estimated UK with-profits Solvency II capital position*	31 Dec 2018	31 Dec 2017
Own Funds (£bn)	**9.7**	9.6
Solvency Capital Requirement (£bn)	**4.2**	4.8
Surplus (£bn)	**5.5**	4.8
Solvency ratio (%)	**231%**	201%

* The estimated solvency positions include management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date, which for both 2018 and 2017 reflects the approved regulatory position.

Reconciliation of UK with-profits IFRS unallocated surplus to Solvency II Own Funds[1]

A reconciliation between the IFRS unallocated surplus and Solvency II Own Funds for UK with-profits business is as follows:

Reconciliation of UK with-profits funds	31 Dec 2018 £bn	31 Dec 2017 £bn
IFRS unallocated surplus of UK with-profits funds	**13.3**	13.5
Value of shareholder transfers	**(2.4)**	(2.7)
Risk margin (net of transitional measures)	**(1.0)**	(0.7)
Other valuation differences	**(0.2)**	(0.5)
Estimated Solvency II Own Funds	**9.7**	9.6

Annual regulatory reporting

The Group will publish its Solvency and Financial Condition Report and related quantitative templates no later than 4 June 2019. The templates will require us to combine the Group shareholder solvency position with those of all other ring fenced funds across the Group. In combining these solvency positions, the contribution to own funds from these ring fenced funds will be set equal to their aggregate solvency capital requirements, estimated at £5.6 billion (ie the solvency surplus in these ring fenced funds will not be captured in the templates). There will be no impact on the reported Group Solvency II surplus.

Statement of independent review in respect of Solvency II Capital Position at 31 December 2018

The methodology, assumptions and overall result have been subject to examination by KPMG LLP.

Notes

1 The UK with-profits capital position includes the PAC with-profits sub-fund, the Scottish Amicable Insurance Fund and the Defined Charge Participating Sub-Fund.

2 The insurance subsidiaries of PAC are Prudential International Assurance plc and Prudential Pensions Limited. Prudential General Insurance Hong Kong Limited and Prudential Hong Kong Limited are no longer subsidiaries of PAC following the transfer of these Hong Kong subsidiaries to Prudential Corporation Asia Limited in 2018.

III Calculation of alternative performance measures

The annual report uses alternative performance measures (APMs) to provide more relevant explanations of the Group's financial position and performance. This section sets out explanations for each APM and reconciliations to relevant IFRS balances.

III(a) Reconciliation of adjusted IFRS operating profit based on longer-term investment returns to profit before tax

The annual report uses alternative performance measures (APMs) to provide more relevant explanations of the Group's financial position and performance. This section sets out explanations for each APM and reconciliations to relevant IFRS balances.

Adjusted IFRS operating profit attributable to shareholders based on longer-term investment returns presents the operating performance of the business. This measurement basis adjusts for the following items within total IFRS profit before tax:

- Short-term fluctuations in investment returns on shareholder-backed business;
- Amortisation of acquisition accounting adjustments arising on the purchase of business; and
- Gain or loss on corporate transactions, such as disposals undertaken in the year.

More details on how adjusted IFRS operating profit based on longer-term investment returns is determined are included in note B1.3 of the IFRS financial statements.

III(b) Calculation of return on IFRS shareholders' funds

Return on IFRS shareholders' funds is calculated as operating profit based on longer-term investment returns net of tax and non-controlling interests divided by opening shareholders' funds. Operating profit based on longer-term investment returns is reconciled to IFRS profit before tax in note B1 to the IFRS financial statements.

	Note	2018 £m	2017 £m
Operating profit based on longer-term investment returns	B1.1	**4,827**	4,699
Tax on operating profit		**(792)**	(971)
Profit attributable to non-controlling interests		**(3)**	(1)
Operating profit based on longer-term investment returns, net of tax and non-controlling interests		**4,032**	3,727
Opening shareholders' funds		**16,087**	14,666
Return on shareholders' funds		**25%**	25%

III(c) Calculation of IFRS gearing ratio

Gearing ratio is calculated as net core structural borrowings of shareholder-financed operations divided by closing IFRS shareholders' funds plus net core structural borrowings.

	Note	31 Dec 2018 £m	31 Dec 2017 £m
Core structural borrowings of shareholder-financed operations	C6.1	**7,664**	6,280
Less holding company cash and short-term investments	II(a)	**(3,236)**	(2,264)
Net core structural borrowings of shareholder-financed operations		**4,428**	4,016
Closing shareholders' funds		**17,249**	16,087
Shareholders' funds plus net core structural borrowings		**21,677**	20,103
Gearing ratio		**20%**	20%

III(d) Calculation of IFRS shareholders' funds per share

IFRS shareholders' funds per share is calculated as closing IFRS shareholders' funds divided by the number of issued shares at the balance sheet date.

	Note	31 Dec 2018	31 Dec 2017
Closing shareholders' funds (£ million)		**17,249**	16,087
Number of issued shares at year end (millions)	C10	**2,593**	2,587
Shareholders' funds per share (pence)		**665**	622

III(e) Calculation of asset management cost/income ratio

The asset management cost/income ratio is calculated as asset management operating expenses, adjusted for commission and joint venture contribution, divided by asset management total IFRS revenue adjusted for commission, joint venture contribution, performance-related fees and non-operating items.

	M&GPrudential asset management	
	2018 £m	2017 £m
Operating income used in cost/income ratio	**1,100**	1,034
Commission	**313**	351
Performance-related fees	**15**	53
Investment Return	**(14)**	–
Short-term fluctuations in investment returns on shareholder backed business	**(15)**	6
Total IFRS revenue	**1,399**	1,444
Operating expense used in cost/income ratio	**654**	602
Investment Return	**(14)**	–
Commission	**313**	351
IFRS charges	**953**	953
Cost/income ratio – Operating expense/operating income	**59%**	58%

	Eastspring Investments	
	2018 £m	2017 £m
Operating income before performance-related fees used in cost/income ratio	**424**	421
Share of joint venture revenue	**(188)**	(176)
Commission	**118**	103
Performance-related fees	**17**	17
Total IFRS revenue	**371**	365
Operating expense used in cost/income ratio	**232**	238
Share of joint venture expense	**(100)**	(92)
Commission	**118**	103
IFRS charges	**250**	249
Cost/income ratio – Operating expense/operating income before performance-related fees	**55%**	56%

III(f) Reconciliation of Asia renewal insurance premium to gross earned premiums

Asia renewal insurance premium is calculated as IFRS gross earned premiums less new business premiums and adjusted for the contribution from joint ventures.

	Note	2018 £m	AER 2017 £m	CER 2017 £m
Asia renewal insurance premium		**12,856**	11,482	11,087
Add: General insurance premium		**90**	89	87
Add: IFRS gross earned premium from new regular and single premium business		**4,809**	4,986	4,819
Less: Renewal premiums from joint ventures		**(1,286)**	(1,068)	(1,022)
Add: premiums relating to sold Korea life business		**–**	199	197
Asia segment IFRS gross earned premium	B1.4	**16,469**	15,688	15,168

III(g) Reconciliation of APE new business sales to earned premiums

The Group reports APE new business sales as a measure of the new policies sold in the year. This differs from the IFRS measure of premiums earned as shown below:

	Note	2018 £m	2017 £m
Annual premium equivalents as published		**6,802**	6,958
Adjustment to include 100% of single premiums on new business sold in the year[note (i)]		**28,009**	28,769
Premiums from in-force business and other adjustments[note (ii)]		**12,413**	8,278
Gross premiums earned	B1.4	**47,224**	44,005
Outward reinsurance premiums[note (iii)]	B1.4	**(14,023)**	(2,062)
Earned premiums, net of reinsurance as shown in the IFRS financial statements	B1.4	**33,201**	41,943

Notes

(i) APE new business sales only include one tenth of single premiums, recorded on policies sold in the year. Gross premiums earned include 100 per cent of such premiums.

(ii) Other adjustments principally include amounts in respect of the following:

- Gross premiums earned include premiums from existing in-force business as well as new business. The most significant amount is recorded in Asia, where a significant portion of regular premium business is written. Asia in-force premiums form the vast majority of the other adjustment amount;
- In October 2018, Jackson entered into a 100 per cent reinsurance agreement with John Hancock Life Insurance Company to acquire a closed block of group pay-out annuity business. The transaction resulted in an addition to gross premiums earned of £3.7 billion. No amounts were included in APE new business sales.
- APE includes new policies written in the year which are classified as investment contracts without discretionary participation features under IFRS 4, arising mainly in Jackson for guaranteed investment contracts and in M&GPrudential for certain unit-linked savings and similar contracts. These are excluded from gross premiums earned and recorded as deposits;

- APE new business sales are annualised while gross premiums earned are recorded only when revenues are due; and
- For the purpose of reporting APE new business sales, we include the Group's share of amounts sold by the Group's insurance joint ventures and associates. Under IFRS, joint ventures and associates are equity accounted and so no amounts are included within gross premiums earned.

(iii) Outward reinsurance premiums in 2018 include £(12,149) million in respect of the reinsurance of the UK annuity portfolio.

III(h) Reconciliation between IFRS and EEV shareholders' funds

The table below shows the reconciliation of EEV shareholders' funds and IFRS shareholders' funds at the end of the year:

	31 Dec 2018 £m	31 Dec 2017 £m
EEV shareholders' funds	**49,782**	44,698
Less: Value of in-force business of long-term business[note (i)]	**(33,013)**	(29,410)
Deferred acquisition costs assigned zero value for EEV purposes	**10,077**	9,227
Other[note (ii)]	**(9,597)**	(8,428)
IFRS shareholders' funds	**17,249**	16,087

Notes

(i) The EEV shareholders' funds comprises the present value of the shareholders' interest in the value of in-force business, net worth of long-term business operations and IFRS shareholders' funds of asset management and other operations. The value of in-force business reflects the present value of future shareholder cash flows from long-term in-force business which are not captured as shareholders' interest on an IFRS basis. Net worth represents the net assets for EEV reporting purposes that reflect the regulatory basis position, sometimes with adjustments to achieve consistency with the IFRS treatment of certain items.

(ii) Other adjustments represent asset and liability valuation differences between IFRS and the local regulatory reporting basis used to value net worth for long-term insurance operations. For the UK, this would be the difference between IFRS and Solvency II.

It also includes the mark to market of the Group's core structural borrowings which are fair valued under EEV but not IFRS. The most significant valuation differences relate to changes in the valuation of insurance liabilities. For example, in Jackson where IFRS liabilities are higher than the local regulatory basis as they are principally based on policyholder account balances (with a deferred acquisition costs recognised as an asset) whereas the local regulatory basis used for EEV is based on future cash flows due to the policyholder on a prudent basis with consideration of an expense allowance as applicable, but with no separate deferred acquisition cost asset.

III(i)Reconciliation of EEV operating profit based on longer-term investment returns

To the extent applicable, the presentation of the EEV post-tax profit for the year is consistent in the classification between operating and non-operating results with the basis that the Group applies for the analysis of IFRS basis results. Operating results reflect underlying results including longer-term investment returns, which are determined following the EEV Principles issued by the European Insurance CFO Forum.

Non-operating results comprise:

— Short-term fluctuations in investment returns;
— The mark to market value movements on core structural borrowings;
— The effect of changes in economic assumptions; and
— The impact of corporate transactions undertaken in the year.

More details on how EEV post-tax profit is determined and the components of EEV operating profit are included in note 13 of the EEV supplementary basis of results.

III(j) Calculation of return on embedded value

Return on embedded value is calculated as the EEV post-tax operating profit based on longer-term investment returns, as a percentage of opening EEV basis shareholders' funds.

	2018	2017
EEV operating profit based on longer-term investment returns (£ million)	**7,563**	6,598
Opening EEV basis shareholders' funds (£ million)	**44,698**	38,968
Return on embedded value (%)	**17%**	17%

III(k) Calculation of EEV shareholders' funds per share

EEV shareholders' funds per share is calculated as closing EEV shareholders' funds divided by the number of issued shares at the balance sheet date. EEV shareholders' funds per share excluding goodwill attributable to shareholders is calculated in the same manner, except goodwill attributable to shareholders is deducted from closing EEV shareholders' funds.

	31 Dec 2018	31 Dec 2017
Closing EEV shareholders' funds (£ million)	**49,782**	44,698
Less: Goodwill attributable to shareholders (£ million)	**(1,651)**	(1,458)
Closing EEV shareholders' funds excluding goodwill attributable to shareholders (£ million)	**48,131**	43,240
Number of issued shares at year end (millions)	**2,593**	2,587
Shareholders' funds per share (in pence)	**1,920p**	1,728p
Shareholders' funds per share excluding goodwill attributable to shareholders (in pence)	**1,856p**	1,671p

European Embedded Value (EEV) basis results

Notes on the EEV basis results

Description of EEV basis reporting

In broad terms, IFRS profit for long-term business reflects the aggregate of results on a traditional accounting basis. By contrast, EEV is a way of reporting the value of the life insurance business.

The EEV basis results have been prepared in accordance with the EEV Principles dated April 2016, issued by the European Insurance CFO Forum. The EEV Principles provide consistent definitions, a framework for setting actuarial assumptions, and an approach to the underlying methodology and disclosures.

Results prepared under the EEV Principles capture the discounted value of future profits expected to arise from the current book of long-term business. The results are prepared by projecting cash flows, by product, using best estimate assumptions for all relevant factors. Furthermore, in determining these expected profits, full allowance is made for the risks attached to their emergence and the associated cost of capital, taking into account recent experience in assessing likely future persistency, mortality, morbidity and expenses. Further details are explained in notes 13 and 14.

* The additional financial information is not covered by the KPMG LLP independent audit opinion.

European Embedded Value (EEV) Basis Results

POST-TAX OPERATING PROFIT BASED ON LONGER-TERM INVESTMENT RETURNS

	Note	2018 £m	2017 £m note (iii)
Asia operations			
New business	3	**2,604**	2,368
Business in force	4	**1,783**	1,337
Long-term business		**4,387**	3,705
Asset management		**159**	155
Total		**4,546**	3,860
US operations			
New business	3	**921**	906
Business in force	4	**1,194**	1,237
Long-term business		**2,115**	2,143
Asset management		**3**	7
Total		**2,118**	2,150
UK and Europe operations			
New business	3	**352**	342
Business in force	4	**1,022**	673
Long-term business		**1,374**	1,015
General insurance commission		**15**	13
Total insurance operations		**1,389**	1,028
Asset management		**392**	403
Total		**1,781**	1,431
Other income and expenditure[note (i)]		**(726)**	(746)
Restructuring costs[note (ii)]		**(156)**	(97)
Operating profit based on longer-term investment returns		**7,563**	6,598
Analysed as profit (loss) from:			
New business	3	**3,877**	3,616
Business in force	4	**3,999**	3,247
Long-term business		**7,876**	6,863
Asset management and general insurance commission		**569**	578
Other results		**(882)**	(843)
		7,563	6,598

Notes

(i) EEV basis other income and expenditure represents the post-tax IFRS basis results for other operations (including Group and Asia Regional Head Office, holding company borrowings, Africa operations and Prudential Capital) less the unwind of expected margins on the internal management of the assets of the covered business (as explained in note 13(i)(g)).

(ii) Restructuring costs comprise the post-tax charge recognised on an IFRS basis and the additional amount recognised on an EEV basis for the shareholders' share incurred by the with-profits funds, representing the cost of business transformation and integration.

(iii) The comparative results have been prepared using previously reported average exchange rates for the year.

POST-TAX SUMMARISED CONSOLIDATED INCOME STATEMENT

	Note	2018 £m	2017 £m
Asia operations		**4,546**	3,860
US operations		**2,118**	2,150
UK and Europe operations		**1,781**	1,431
Other income and expenditure		**(726)**	(746)
Restructuring costs		**(156)**	(97)
Operating profit based on longer-term investment returns		**7,563**	6,598
Short-term fluctuations in investment returns	5	**(3,219)**	2,111
Effect of changes in economic assumptions	6	**146**	(102)
Mark to market value movements on core structural borrowings		**549**	(326)
Impact of US tax reform	16	**-**	390
(Loss) profit attaching to corporate transactions	17	**(451)**	80
Total non-operating (loss) profit		**(2,975)**	2,153
Profit for the year		**4,588**	8,751
Attributable to:			
Equity holders of the Company		**4,585**	8,750
Non-controlling interests		**3**	1
		4,588	8,751

Basic earnings per share

	2018	2017
Based on post-tax operating profit including longer-term investment returns after non-controlling interests (in pence)	**293.6p**	257.0p
Based on post-tax profit attributable to equity holders of the Company (in pence)	**178.1p**	340.9p
Weighted average number of shares (millions)	**2,575**	2,567

MOVEMENT IN SHAREHOLDERS' EQUITY

	Note	2018 £m	2017 £m
Profit for the year attributable to equity holders of the Company		**4,585**	8,750
Items taken directly to equity:			
Exchange movements on foreign operations and net investment hedges		**1,706**	(2,045)
External dividends		**(1,244)**	(1,159)
Mark to market value movements on Jackson assets backing surplus and required capital		**(95)**	40
Other reserve movements		**132**	144
Net increase in shareholders' equity	8	**5,084**	5,730
Shareholders' equity at beginning of year	8	**44,698**	38,968
Shareholders' equity at end of year	8	**49,782**	44,698

	31 Dec 2018 £m			31 Dec 2017 £m		
Comprising:	Long-term business operations	Asset management and other operations	Group total	Long-term business operations	Asset management and other operations	Group total
Asia operations	**24,580**	**552**	**25,132**	21,191	401	21,592
US operations	**14,650**	**40**	**14,690**	13,257	235	13,492
UK and Europe operations	**11,409**	**2,175**	**13,584**	11,713	1,914	13,627
Other operations	**-**	**(3,624)**	**(3,624)**	-	(4,013)	(4,013)
Shareholders' equity at end of year	**50,639**	**(857)**	**49,782**	46,161	(1,463)	44,698
Representing:						
Net assets attributable to equity holders of the Company excluding acquired goodwill, holding company net borrowings and non-controlling interests	**50,388**	**2,105**	**52,493**	45,917	1,562	47,479
Acquired goodwill*	**251**	**1,400**	**1,651**	244	1,214	1,458
Holding company net borrowings at market value[note 7]	-	**(4,362)**	**(4,362)**	-	(4,239)	(4,239)
	50,639	**(857)**	**49,782**	46,161	(1,463)	44,698

* Acquired goodwill for asset management and other operations for 2018 includes goodwill recognised on acquisition of TMB Asset Management Co., Ltd. as discussed in note D1.2 of the IFRS statements.

SUMMARY STATEMENT OF FINANCIAL POSITION

	Note	31 Dec 2018 £m	31 Dec 2017 £m
Total assets less liabilities, before deduction of insurance funds*		**431,269**	434,615
Less insurance funds:			
Policyholder liabilities (net of reinsurers' share) and unallocated surplus of with-profits funds		**(414,002)**	(418,521)
Less shareholders' accrued interest in the long-term business	8	**32,533**	28,611
		(381,469)	(389,910)
Less non-controlling interests		**(18)**	(7)
Total net assets attributable to equity holders of the Company	8	**49,782**	44,698
Share capital		**130**	129
Share premium		**1,964**	1,948
IFRS basis shareholders' reserves		**15,155**	14,010
Total IFRS basis shareholders' equity	8	**17,249**	16,087
Additional EEV basis retained profit	8	**32,533**	28,611
Total EEV basis shareholders' equity	8	**49,782**	44,698

* Including liabilities in respect of insurance products classified as investment contracts under IFRS 4.

Net asset value per share

	31 Dec 2018	31 Dec 2017
Based on EEV basis shareholders' equity of £49,782 million (31 December 2017: £44,698 million) (in pence)	**1,920p**	1,728p
Number of issued shares at year end (millions)	**2,593**	2,587
Annualised return on embedded value*	**17%**	17%

* Annualised return on embedded value is based on EEV post-tax operating profit after non-controlling interests, as a percentage of opening EEV basis shareholders' equity.

NOTES ON THE EEV BASIS RESULTS

1 Basis of preparation

The EEV basis results have been prepared in accordance with the EEV Principles dated April 2016, issued by the European Insurance CFO Forum. Where appropriate, the EEV basis results include the effects of adoption of EU-endorsed IFRS.

The directors are responsible for the preparation of the supplementary information in accordance with the EEV Principles. The auditors have reported on the 2018 EEV basis results supplement to the Company's statutory accounts for 2018. Their report was (i) unqualified and (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report. The 2017 results have been derived from the EEV basis results supplement to the Company's statutory accounts for 2017. The supplement included an unqualified audit report from the auditors.

A detailed description of the EEV methodology and accounting presentation is provided in note 13.

2 Results analysis by business area

The 2017 comparative results are shown below on both actual exchange rates (AER) and constant exchange rates (CER) bases. The 2017 CER comparative results are translated at 2018 average exchange rates.

Annual premium equivalents (APE)note 15

		2018 £m	2017 £m		% change	
	Note		AER	CER	AER	CER
Asia		**3,744**	3,805	3,671	(2)%	2%
US		**1,542**	1,662	1,605	(7)%	(4)%
UK and Europe		**1,516**	1,491	1,491	2%	2%
Group total	3	**6,802**	6,958	6,767	(2)%	1%

Post-tax operating profit

		2018 £m	2017 £m		% change	
	Note		AER	CER	AER	CER
Asia operations						
New business	3	**2,604**	2,368	2,282	10%	14%
Business in force	4	**1,783**	1,337	1,280	33%	39%
Long-term business		**4,387**	3,705	3,562	18%	23%
Asset management		**159**	155	150	3%	6%
Total		**4,546**	3,860	3,712	18%	22%
US operations						
New business	3	**921**	906	874	2%	5%
Business in force	4	**1,194**	1,237	1,195	(3)%	0%
Long-term business		**2,115**	2,143	2,069	(1)%	2%
Asset management		**3**	7	7	(57)%	(57)%
Total		**2,118**	2,150	2,076	(1)%	2%
UK and Europe operations						
New business	3	**352**	342	342	3%	3%
Business in force	4	**1,022**	673	673	52%	52%
Long-term business		**1,374**	1,015	1,015	35%	35%
General insurance commission*		**15**	13	13	15%	15%
Total insurance operations		**1,389**	1,028	1,028	35%	35%
Asset management		**392**	403	403	(3)%	(3)%
Total		**1,781**	1,431	1,431	24%	24%
Other income and expenditure		**(726)**	(746)	(740)	3%	2%
Restructuring costs		**(156)**	(97)	(97)	(61)%	(61)%
Operating profit based on longer-term investment returns		**7,563**	6,598	6,382	15%	19%
Analysed as profit (loss) from:						
New business	3	**3,877**	3,616	3,498	7%	11%
Business in force	4	**3,999**	3,247	3,148	23%	27%
Total long-term business		**7,876**	6,863	6,646	15%	19%
Asset management and general insurance commission		**569**	578	573	(2)%	(1)%
Other results		**(882)**	(843)	(837)	(5)%	(5)%
		7,563	6,598	6,382	15%	19%

* The majority of the general insurance commission is not expected to recur in future years.

Post-tax profit

	Note	2018 £m	2017 £m AER	2017 £m CER	% change AER	% change CER
Operating profit based on longer-term investment returns		**7,563**	6,598	6,382	15%	19%
Short-term fluctuations in investment returns	5	**(3,219)**	2,111	2,057		
Effect of changes in economic assumptions	6	**146**	(102)	(91)		
Mark to market value movements on core structural borrowings		**549**	(326)	(326)		
Impact of US tax reform	16	**-**	390	376		
(Loss) profit attaching to corporate transactions	17	**(451)**	80	77		
Total non-operating (loss) profit		**(2,975)**	2,153	2,093		
Profit for the year		**4,588**	8,751	8,475	(48)%	(46)%

Basic earnings per share

	2018	2017 AER	2017 CER	% change AER	% change CER
Based on post-tax operating profit including longer-term investment returns after non-controlling interests (in pence)	**293.6p**	257.0p	248.6p	14%	18%
Based on post-tax profit attributable to equity holders of the Company (in pence)	**178.1p**	340.9p	330.2p	(48)%	(46)%

3 Analysis of new business contribution

(i) Group summary for long-term business operations

2018	Annual premium equivalents (APE) £m note 15	Present value of new business premiums (PVNBP) £m note 15	New business contribution £m	New business margin APE %	New business margin PVNBP %
Asia note (ii)	**3,744**	**20,754**	**2,604**	**70**	**12.5**
US	**1,542**	**15,423**	**921**	**60**	**6.0**
UK and Europe	**1,516**	**14,073**	**352**	**23**	**2.5**
Total	**6,802**	**50,250**	**3,877**	**57**	**7.7**

2017	Annual premium equivalents (APE) £m note 15	Present value of new business premiums (PVNBP) £m note 15	New business contribution £m	New business margin APE %	New business margin PVNBP %
Asia note (ii)	3,805	20,405	2,368	62	11.6
US	1,662	16,622	906	55	5.5
UK and Europe	1,491	13,784	342	23	2.5
Total	6,958	50,811	3,616	52	7.1

Note
After allowing for foreign exchange effects of £(118) million, the new business contribution has increased by £379 million on a CER basis. The increase is driven by a beneficial effect of pricing, product mix and other actions of £278 million reflecting our strategic emphasis on increasing sales from health and protection business in Asia, together with changes in long-term interest rates and other economic assumptions (£83 million) and higher sales volumes (a contribution of £18 million).

(ii) Asia new business contribution by business unit

	2018 £m	2017 £m AER	2017 £m CER
China	**149**	133	131
Hong Kong	**1,729**	1,535	1,474
Indonesia	**122**	174	158
Taiwan	**46**	57	56
Other	**558**	469	463
Total	**2,604**	2,368	2,282

4 Operating profit from business in force

(i) Group summary for long-term business operations

	2018 £m			
	Asia note (ii)	**US** note (iii)	**UK and Europe** note (iv)	**Total**
Unwind of discount and other expected returns	**1,218**	**881**	**474**	**2,573**
Effect of changes in operating assumptions	**342**	**115**	**330**	**787**
Experience variances and other items	**223**	**198**	**218**	**639**
Group total	**1,783**	**1,194**	**1,022**	**3,999**

	2017 £m			
	Asia note (ii)	**US** note (iii)	**UK and Europe** note (iv)	**Total**
Unwind of discount and other expected returns	1,007	694	465	2,166
Effect of changes in operating assumptions	241	196	195	632
Experience variances and other items	89	347	13	449
Group total	1,337	1,237	673	3,247

Note

The movement in operating profit from business in force of £752 million from £3,247 million for 2017 to £3,999 million for 2018 comprises:

	£m
Movement in unwind of discount and other expected returns:	
Growth in opening value of in-force business	**368**
Effect of interest rates and other economic assumptions	**101**
Foreign exchange movements	**(62)**
	407
Movement in effect of changes in operating assumptions, experience variances and other items	**345**
Net movement in operating profit from business in force	**752**

(ii) Asia

	2018 £m	**2017 £m**
Unwind of discount and other expected returns[note (a)]	**1,218**	1,007
Effect of changes in operating assumptions[note (b)]	**342**	241
Experience variances and other items[note (c)]	**223**	89
Total	**1,783**	1,337

Notes

(a) The £211 million increase in unwind of discount and other expected returns from £1,007 million in 2017 to £1,218 million in 2018 is primarily driven by the growth in the in-force book and a positive £51 million impact from movements in long-term interest rates and other economic assumptions, partially offset by a negative effect of foreign exchange movements of £(38) million.

(b) The effects of changes in operating assumptions of £342 million reflects the outcome from the annual review of persistency, claims and expense experience together with the benefit of medical repricing management actions. It also reflects profits arising after reflection of a number of tax changes across a number of countries.

(c) The £223 million effect of experience variances and other items in 2018 is driven by positive mortality and morbidity experiences in a number of local business units, together with positive persistency variances from participating and health and protection products.

(iii) US

	2018 £m	2017 £m
Unwind of discount and other expected returns[note (a)]	**881**	694
Effect of changes in operating assumptions[note (b)]	**115**	196
Experience variances and other items:		
Spread experience variance	**39**	71
Amortisation of interest-related realised gains and losses	**92**	91
Other[note (c)]	**67**	185
	198	347
Total	**1,194**	1,237

Notes

(a) The £187 million increase in unwind of discount and other expected returns from £694 million in 2017 to £881 million in 2018 reflects prior period growth in the in-force book, a £30 million benefit from a 30 basis point increase in the US 10-year treasury yield in the year offset by a £(24) million negative effect for foreign exchange movements.

(b) The effect of operating assumption changes of £115 million (2017: £196 million) mainly relates to routine updates for persistency and policyholder utilisation.

(c) Other experience variances of £198 million include the effects of positive mortality and persistency experience in the year.

(iv) UK and Europe

	2018 £m	2017 £m
Unwind of discount and other expected returns[note (a)]	**474**	465
Change in longevity assumption basis[note (b)]	**330**	195
Other items[note (c)]	**218**	13
Total	**1,022**	673

Notes

(a) Unwind of discount and expected returns for 2018 is broadly consistent with 2017 and reflects the benefit from a 10 basis point increase in the 15-year swap yields offset by the impact from the reinsurance of part of its shareholder annuity portfolio to Rothesay Life as discussed in note 17.

(b) The credit of £330 million (2017: £195 million) relates to changes to annuitant mortality assumptions to reflect current mortality experience, which has shown a slowdown in life expectancy improvements in recent periods, and the adoption of the Continuous Mortality Investigation (CMI) 2016 model (2017: CMI 2015 model) as the basis for future mortality improvements.

(c) Other items comprise the following:

	2018 £m	2017 £m
Longevity reinsurance	**-**	(6)
Impact of specific management actions to improve solvency position	**141**	127
Provision for cost of undertaking past non-advised annuity sales review and related redress[note (d)]	**-**	(187)
Insurance recoveries in respect of the above costs[note (d)]	**138**	-
Provision for guaranteed minimum pension equalisation[note (e)]	**(48)**	-
Other	**(13)**	79
	218	13

(d) The UK business has agreed with the Financial Conduct Authority (FCA) to review annuities sold without advice after 1 July 2008 to its contract-based defined contribution pension customers. A gross provision of £(330) million, post-tax and before costs incurred, was established at 31 December 2017, of which £(187) million was charged in full year 2017. During 2018, the Group agreed with its professional indemnity insurers that they will meet £166 million of the Group's claims costs, which will be paid as the Group incurs costs/redress. This has been recognised on the Group balance sheet at 31 December 2018 and a post-tax credit of £138 million is recognised in the EEV operating profit. For more details, refer to note C11 of the IFRS financial statements.

(e) An allowance has been made for higher liabilities that may arise when applying the recent High Court decision to equalise guaranteed minimum pension (GMP) benefits between males and females for certain pension products sold by the UK business.

5 Short-term fluctuations in investment returns

(i) Group summary

	2018 £m	2017 £m
Asia operations[note (ii)]	**(1,029)**	887
US operations[note (iii)]	**(1,481)**	582
UK and Europe operations[note (iv)]	**(721)**	621
Other operations	**12**	21
Group total	**(3,219)**	2,111

(ii) Asia operations

	2018 £m	2017 £m
Hong Kong	**(552)**	531
Singapore	**(233)**	126
Other	**(244)**	230
Total	**(1,029)**	887

Note
For 2018, the charge of £(1,029) million mainly represents the reduction of bond and equity values in Hong Kong and lower than expected investment returns on participating and unit-linked business in Indonesia, Singapore and Malaysia.

(iii) US operations

	2018 £m	2017 £m
Investment return related experience on fixed income securities[note (a)]	**60**	(46)
Investment return related impact due to changed expectation of profits on in-force variable annuity business in future periods based on current year separate account return, net of related hedging activity and other items[note (b)]	**(1,541)**	628
Total	**(1,481)**	582

Notes
(a) The net result relating to fixed income securities reflects a number of offsetting items as follows:
- The impact on portfolio yields of changes in the asset portfolio in the year;
- The difference between actual realised gains and losses and the amortisation of interest-related realised gains and losses that is recorded within operating profit; and
- Credit experience (versus the longer-term assumption).

(b) This item reflects the net impact of:
- Changes in projected future fees and future benefit costs arising from the difference between the actual growth in separate account asset values of negative (5.4) per cent and that assumed of 6.2 per cent (2017: actual growth of 17.5 per cent compared to assumed growth of 5.9 per cent); and
- Related hedging activity arising from realised and unrealised gains and losses on equity-related hedges and interest rate options, and other items.

(iv) UK and Europe operations

	2018 £m	2017 £m
Insurance operations:		
Shareholder-backed annuity business	**(151)**	387
With-profits and other business	**(557)**	229
Asset management	**(13)**	5
Total	**(721)**	621

Note
The £(721) million fluctuation in 2018 primarily represents the impact of achieving a (2.5) per cent pre-tax return on the with-profits fund (including unallocated surplus) compared to the assumed rate of return of 4.2 per cent (2017: achieved return of 9 per cent compared to assumed rate of 5 per cent), partially offset by the effect of a partial hedge of future shareholder transfers expected to emerge from the UK's with-profits sub-fund entered into to protect future shareholder with-profit transfers from movements in the UK equity market. It also reflects losses on corporate bonds backing shareholder annuity business, reflecting changes to interest rates and credit spreads over the period.

6 Effect of changes in economic assumptions

(i) Group summary for long-term business operations

	2018 £m	2017 £m
Asia note (ii)	**115**	(95)
US note (iii)	**197**	(136)
UK and Europe note (iv)	**(166)**	129
Group total	**146**	(102)

(ii) Asia

	2018 £m	2017 £m
Hong Kong	**165**	(321)
Indonesia	**(94)**	81
Malaysia	**(19)**	59
Singapore	**70**	131
Other	**(7)**	(45)
Total	**115**	(95)

Note
The positive effect in 2018 of £115 million largely arises from movements in long-term interest rates, resulting in higher assumed fund earned rates in Hong Kong and Singapore, partially offset by the impact of valuing future profits for health and protection business at higher discount rates in Indonesia and Malaysia.

(iii) US

	2018 £m	2017 £m
Variable annuity business	**365**	(101)
Fixed annuity and other general account business	**(168)**	(35)
Total	**197**	(136)

Note
For 2018, the credit of £197 million mainly reflects the increase in the assumed separate account return following the 30 basis points increase in the US 10-year treasury yield over the year, resulting in higher projected fee income and a decrease in projected benefit costs for variable annuity business. For fixed annuity and other general account business, the impact reflects the effect on the present value of future projected spread income from the combined increase in interest rates and credit spreads in the year. In June 2018, the National Association of Insurance Commissioners (NAIC) formally approved changes to RBC capital factors that reflected the December 2017 US tax reform. Consequently, the effect of changes in economic assumptions for 2018 of £197 million includes a negative £(23) million impact resulting from these changes.

(iv) UK and Europe

	2018 £m	2017 £m
Shareholder-backed annuity business	**1**	28
With-profits and other business	**(167)**	101
Total	**(166)**	129

Note
The charge of £(166) million includes the impact of the movement in expected long-term rates of investment return, resulting from market movements and changes in asset mix in the year, and risk discount rates. In addition, the effect of changes in economic assumptions for with-profits and other business of £(167) million includes a £(78) million charge for the effect on lower fund earned rates on equities and property as a result of the change in UK indexation of capital gains rules effective from 1 January 2018.

7 Net core structural borrowings of shareholder-financed businesses

	31 Dec 2018 £m			31 Dec 2017 £m		
	IFRS basis	Mark to market value adjustment	EEV basis at market value	IFRS basis	Mark to market value adjustment	EEV basis at market value
Holding company (including central finance subsidiaries) cash and short-term investments	**(3,236)**	**-**	**(3,236)**	(2,264)	-	(2,264)
Central funds						
Subordinated debt	**6,676**	**(44)**	**6,632**	5,272	515	5,787
Senior debt	**517**	**174**	**691**	549	167	716
	7,193	**130**	**7,323**	5,821	682	6,503
Bank loan	**275**	**-**	**275**	-	-	-
Holding company net borrowings	**4,232**	**130**	**4,362**	3,557	682	4,239
Prudential Capital bank loan	**-**	**-**	**-**	275	-	275
Jackson surplus notes	**196**	**53**	**249**	184	61	245
Group total	**4,428**	**183**	**4,611**	4,016	743	4,759

Note
In October 2018, the Company issued three tranches of substitutable core structural borrowings as part of the process required before demerger, to rebalance debt across M&GPrudential and Prudential plc. Total proceeds, net of costs, were £1,630 million. In December 2018, the Company paid £434 million to redeem its US$550 million 7.75 per cent Tier 1 perpetual subordinated notes. The movement in the value of core structural borrowings also includes foreign exchange effects for US dollar denominated debts. For more details on the core structural borrowings, refer to note C6.1 of the IFRS financial statement.

8 Reconciliation of movement in shareholders' equity

	2018 £m				
	Asia operations note (i)	**US operations**	**UK and Europe operations**	**Other operations** note (i)	**Group total** note (iv)
Long-term business:					
New business[note 3]	**2,604**	**921**	**352**	**-**	**3,877**
Business in force[note 4]	**1,783**	**1,194**	**1,022**	**-**	**3,999**
	4,387	**2,115**	**1,374**	**-**	**7,876**
Asset management and general insurance commission	**159**	**3**	**407**	**-**	**569**
Restructuring costs	**(19)**	**(17)**	**(109)**	**(11)**	**(156)**
Other results	**-**	**-**	**-**	**(726)**	**(726)**
Operating profit based on longer-term investment returns	**4,527**	**2,101**	**1,672**	**(737)**	**7,563**
Non-operating items	**(925)**	**(1,313)**	**(1,263)**	**526**	**(2,975)**
Non-controlling interests	**(1)**	**-**	**-**	**(2)**	**(3)**
Profit for the year attributable to equity holders of the Company	**3,601**	**788**	**409**	**(213)**	**4,585**
Other items taken directly to equity:					
Exchange movements on foreign operations and net investment hedges	**1,028**	**862**	**-**	**(184)**	**1,706**
Intra-group dividends and investment in operations[note (ii)]	**(1,177)**	**(337)**	**(447)**	**1,961**	**-**
External dividends	**-**	**-**	**-**	**(1,244)**	**(1,244)**
Mark to market value movements on Jackson assets backing surplus and required capital	**-**	**(95)**	**-**	**-**	**(95)**
Other movements[note (iii)]	**81**	**(20)**	**(5)**	**76**	**132**
Net increase in shareholders' equity	**3,533**	**1,198**	**(43)**	**396**	**5,084**
Shareholders' equity at beginning of year	**21,348**	**13,492**	**13,627**	**(3,769)**	**44,698**
Shareholders' equity at end of year	**24,881**	**14,690**	**13,584**	**(3,373)**	**49,782**
Representing:					
IFRS basis shareholders' equity:					
Net assets (liabilities)	**5,921**	**5,624**	**7,547**	**(3,494)**	**15,598**
Goodwill	**247**	**-**	**1,153**	**251**	**1,651**
IFRS basis shareholders' equity	**6,168**	**5,624**	**8,700**	**(3,243)**	**17,249**
Additional retained profit (loss) on an EEV basis	**18,713**	**9,066**	**4,884**	**(130)**	**32,533**
EEV basis shareholders' equity	**24,881**	**14,690**	**13,584**	**(3,373)**	**49,782**
Balance at beginning of year:					
IFRS basis shareholders' equity:					
Net assets (liabilities)	5,620	5,248	7,092	(3,331)	14,629
Goodwill	61	-	1,153	244	1,458
IFRS basis shareholders' equity	5,681	5,248	8,245	(3,087)	16,087
Additional retained profit (loss) on an EEV basis	15,667	8,244	5,382	(682)	28,611
EEV basis shareholders' equity	21,348	13,492	13,627	(3,769)	44,698

Notes

(i) Other operations of £(3,373) million represents the shareholders' equity of £(3,624) million as shown in the movement in shareholders' equity and includes goodwill of £251 million (2017: £244 million) related to Asia long-term operations.

(ii) Intra-group dividends represent dividends that have been declared in the year and investment in operations reflect movements in share capital. The amounts included for these items in the analysis of movement in free surplus (note 10) are as per the holding company cash flow at transaction rates. The difference primarily relates to intra-group loans, foreign exchange and other non-cash items.

(iii) Other movements include reserve movements in respect of the shareholders' share of actuarial gains and losses on defined benefit pension schemes, share capital subscribed, share-based payments and treasury shares and intra-group transfers between operations which have no overall effect on the Group's embedded value. Also included is the put option recognised on acquisition of TMB Asset Management Co., Ltd. as discussed in note D1.2 of the IFRS financial statements.

(iv) Group total EEV basis shareholders' equity can be further analysed as follows:

	31 Dec 2018 £m				31 Dec 2017 £m			
	Total long-term business operations note 9	**Asset management and general insurance commission**	**Other operations** note (v)	**Group total**	**Total long-term business operations** note 9	**Asset management and general insurance commission**	**Other operations** note (v)	**Group total**
IFRS basis shareholders' equity	**17,725**	**2,767**	**(3,243)**	**17,249**	16,624	2,550	(3,087)	16,087
Additional retained profit (loss) on an EEV basis[note (v)]	**32,663**	**-**	**(130)**	**32,533**	29,293	-	(682)	28,611
EEV basis shareholders' equity	**50,388**	**2,767**	**(3,373)**	**49,782**	45,917	2,550	(3,769)	44,698

(v) The additional retained loss on an EEV basis for other operations represents the mark to market value adjustment for holding company net borrowings of a cumulative charge of £(130) million (31 December 2017: £(682) million) as shown in note 7.

9 Analysis of movement in net worth and value of in-force for long-term business

	2018 £m				
	Free surplus	**Required capital**	**Total net worth**	**Value of in-force business** note (i)	**Total embedded value**
Group					
Shareholders' equity at beginning of year	**6,242**	**10,265**	**16,507**	**29,410**	**45,917**
New business contribution note 3	**(815)**	**619**	**(196)**	**4,073**	**3,877**
Existing business – transfer to net worth	**3,439**	**(776)**	**2,663**	**(2,663)**	**-**
Expected return on existing business note 4	**201**	**195**	**396**	**2,177**	**2,573**
Changes in operating assumptions and experience variances note 4	**778**	**69**	**847**	**579**	**1,426**
Restructuring costs	**(68)**	**-**	**(68)**	**(20)**	**(88)**
Operating profit based on longer-term investment returns	**3,535**	**107**	**3,642**	**4,146**	**7,788**
Non-operating items	**(720)**	**(730)**	**(1,450)**	**(2,008)**	**(3,458)**
Profit for the year	**2,815**	**(623)**	**2,192**	**2,138**	**4,330**
Exchange movements on foreign operations and net investment hedges	**201**	**206**	**407**	**1,465**	**1,872**
Intra-group dividends and investment in operations	**(1,654)**	**-**	**(1,654)**	**-**	**(1,654)**
Other movements	**(77)**	**-**	**(77)**	**-**	**(77)**
Shareholders' equity at end of year	**7,527**	**9,848**	**17,375**	**33,013**	**50,388**
Asia					
New business contribution note 3	**(488)**	**158**	**(330)**	**2,934**	**2,604**
Existing business – transfer to net worth	**1,370**	**(253)**	**1,117**	**(1,117)**	**-**
Expected return on existing business note 4	**68**	**55**	**123**	**1,095**	**1,218**
Changes in operating assumptions and experience variances note 4	**62**	**185**	**247**	**318**	**565**
Operating profit based on longer-term investment returns	**1,012**	**145**	**1,157**	**3,230**	**4,387**
Non-operating items	**(393)**	**15**	**(378)**	**(547)**	**(925)**
Profit for the year	**619**	**160**	**779**	**2,683**	**3,462**
US					
New business contribution note 3	**(225)**	**288**	**63**	**858**	**921**
Existing business – transfer to net worth	**1,462**	**(171)**	**1,291**	**(1,291)**	**-**
Expected return on existing business note 4	**54**	**69**	**123**	**758**	**881**
Changes in operating assumptions and experience variances note 4	**125**	**6**	**131**	**182**	**313**
Restructuring costs	**(17)**	**-**	**(17)**	**-**	**(17)**
Operating profit based on longer-term investment returns	**1,399**	**192**	**1,591**	**507**	**2,098**
Non-operating items note (ii)	**(812)**	**164**	**(648)**	**(635)**	**(1,283)**
Profit for the year	**587**	**356**	**943**	**(128)**	**815**
UK and Europe					
New business contribution note 3	**(102)**	**173**	**71**	**281**	**352**
Existing business – transfer to net worth	**607**	**(352)**	**255**	**(255)**	**-**
Expected return on existing business note 4	**79**	**71**	**150**	**324**	**474**
Changes in operating assumptions and experience variances note 4	**591**	**(122)**	**469**	**79**	**548**
Restructuring costs	**(51)**	**-**	**(51)**	**(20)**	**(71)**
Operating profit based on longer-term investment returns	**1,124**	**(230)**	**894**	**409**	**1,303**
Non-operating items	**485**	**(909)**	**(424)**	**(826)**	**(1,250)**
Profit for the year	**1,609**	**(1,139)**	**470**	**(417)**	**53**

Notes

(i) The net value of in-force business comprises the value of future margins from current in-force business less the cost of holding required capital for long-term business as shown below:

	31 Dec 2018 £m				31 Dec 2017 £m			
	Asia	**US**	**UK and Europe**	**Total**	**Asia**	**US**	**UK and Europe**	**Total**
Value of in-force business before deduction of cost of capital and time value of guarantees	**21,867**	**11,811**	**3,083**	**36,761**	17,539	10,486	3,648	31,673
Cost of capital	**(566)**	**(296)**	**(459)**	**(1,321)**	(588)	(232)	(607)	(1,427)
Cost of time value of guarantees	**(981)**	**(1,446)**	**-**	**(2,427)**	(186)	(650)	-	(836)
Net value of in-force business	**20,320**	**10,069**	**2,624**	**33,013**	16,765	9,604	3,041	29,410
Total net worth	**4,009**	**4,581**	**8,785**	**17,375**	4,182	3,653	8,672	16,507
Total embedded value note 8(iv)	**24,329**	**14,650**	**11,409**	**50,388**	20,947	13,257	11,713	45,917

* The cost of time value of guarantees arises from the variability of economic outcomes in the future and is, where appropriate, calculated as the difference between a full stochastic valuation and a single deterministic valuation as described in note 13(i)(d). Both valuations reflect the level of policyholder benefits (including guaranteed benefits and discretionary bonuses) and associated charges, together with management actions in response to emerging investment and fund solvency conditions. The increase in the cost of time value of guarantees for Asia operations from £(186) million at 31 December 2017 to £(981) million at 31 December 2018 reflects the interaction between these effects on the two valuations at the respective level of interest rates and equity markets, as well as growth in the business over the year. The increase in the cost of time value of guarantees for the US operations from £(650) million at 31 December 2017 to £(1,446) million at 31 December 2018 primarily reflects the reduction in US equity markets during the fourth quarter of 2018.

(ii) In June 2018, the National Association of Insurance Commissioners (NAIC) formally approved changes to RBC capital factors that reflected the December 2017 US tax reform. The 2018 EEV results reflect these changes, with a resulting increase in required capital and a corresponding reduction in free surplus of £(165) million.

10 Analysis of movement in free surplus

For EEV covered business, free surplus is the excess of the regulatory basis net assets for EEV reporting purposes (net worth) over the capital required to support the covered business. Where appropriate, adjustments are made to the net worth so that backing assets are included at fair value rather than cost so as to comply with the EEV Principles. In Asia and the US operations, assets deemed to be inadmissible on local regulatory basis are included in net worth where considered fully recognisable on an EEV basis. Free surplus for asset management operations and the UK general insurance commission is taken to be IFRS basis post-tax earnings and shareholders' equity net of goodwill. Free surplus for other operations (including Group and Asia Regional Head Office, holding company borrowings, Africa operations and Prudential Capital) is taken to be EEV basis post-tax earnings and shareholders' equity net of goodwill, with subordinated debt recorded as free surplus to the extent that it is classified as available capital under Solvency II.

(i) Underlying free surplus generated – insurance and asset management operations

The 2017 comparative results are shown below on both actual exchange rates (AER) and constant exchange rates (CER) bases. The 2017 CER comparative results are translated at 2018 average exchange rates.

	2018 £m	2017 £m		% change	
		AER	CER	AER	CER
Asia operations					
Underlying free surplus generated from in-force life business	**1,500**	1,407	1,343	7%	12%
Investment in new business note (iii)(a)	**(488)**	(484)	(466)	(1)%	(5)%
Long-term business	**1,012**	923	877	10%	15%
Asset management	**159**	155	150	3%	6%
Total	**1,171**	1,078	1,027	9%	14%
US operations					
Underlying free surplus generated from in-force life business	**1,641**	1,575	1,520	4%	8%
Investment in new business note (iii)(a)	**(225)**	(254)	(245)	11%	8%
Long-term business	**1,416**	1,321	1,275	7%	11%
Asset management	**3**	7	7	(57)%	(57)%
Total	**1,419**	1,328	1,282	7%	11%
UK and Europe operations					
Underlying free surplus generated from in-force life business	**1,277**	1,070	1,070	19%	19%
Investment in new business note (iii)(a)	**(102)**	(175)	(175)	42%	42%
Long-term business	**1,175**	895	895	31%	31%
General insurance commission	**15**	13	13	15%	15%
Total insurance operations	**1,190**	908	908	31%	31%
Asset management	**392**	403	403	(3)%	(3)%
Total	**1,582**	1,311	1,311	21%	21%
Underlying free surplus generated from insurance and asset management operations before restructuring costs	**4,172**	3,717	3,620	12%	15%
Restructuring costs	**(125)**	(77)	(77)	(62)%	(62)%
Underlying free surplus generated from insurance and asset management operations	**4,047**	3,640	3,543	11%	14%
Representing:					
Expected in-force cash flows (including expected return on net assets)	**3,640**	3,417	3,315	7%	10%
Effects of changes in operating assumptions, operating experience variances and other items before restructuring costs	**778**	635	618	23%	26%
Underlying free surplus generated from in-force life business before restructuring costs	**4,418**	4,052	3,933	9%	12%
Investment in new business note (iii)(a)	**(815)**	(913)	(886)	11%	8%
Total long-term business	**3,603**	3,139	3,047	15%	18%
Asset management and general insurance commission	**569**	578	573	(2)%	(1)%
Restructuring costs	**(125)**	(77)	(77)	(62)%	(62)%
	4,047	3,640	3,543	11%	14%

(ii) Underlying free surplus generated – Group total

	2018 £m	2017 £m		% change	
		AER	CER	AER	CER
Underlying free surplus generated from insurance and asset management operations note (i)	**4,047**	3,640	3,543	11%	14%
Other income and expenditure	**(737)**	(756)	(750)	3%	2%
Group total	**3,310**	2,884	2,793	15%	19%

(iii) Movement in free surplus

	2018 £m					
	Asia operations	US operations	UK and Europe operations	Total insurance and asset management operations	Other operations	Group total
Underlying free surplus generated before restructuring costs	**1,171**	**1,419**	**1,582**	**4,172**	**(726)**	**3,446**
Restructuring costs	**(19)**	**(17)**	**(89)**	**(125)**	**(11)**	**(136)**
Underlying free surplus generated[notes (i)(ii)]	**1,152**	**1,402**	**1,493**	**4,047**	**(737)**	**3,310**
Non-operating items[note (b)]	**(393)**	**(842)**	**472**	**(763)**	**(22)**	**(785)**
	759	**560**	**1,965**	**3,284**	**(759)**	**2,525**
Net cash flows to parent company[note (c)]	**(699)**	**(342)**	**(691)**	**(1,732)**	**1,732**	**-**
External dividends	**-**	**-**	**-**	**-**	**(1,244)**	**(1,244)**
Exchange rate movements, timing differences and other items[note (d)]	**(496)**	**21**	**239**	**(236)**	**1,505**	**1,269**
Net movement in free surplus	**(436)**	**239**	**1,513**	**1,316**	**1,234**	**2,550**
Balance at beginning of year	**2,470**	**1,928**	**3,180**	**7,578**	**1,774**	**9,352**
Balance at end of year	**2,034**	**2,167**	**4,693**	**8,894**	**3,008**	**11,902**

	2017 £m					
	Asia operations	US operations	UK and Europe operations	Total insurance and asset management operations	Other operations	Group total
Underlying free surplus generated before restructuring costs	1,078	1,328	1,311	3,717	(746)	2,971
Restructuring costs	(14)	-	(63)	(77)	(10)	(87)
Underlying free surplus generated[notes(i)(ii)]	1,064	1,328	1,248	3,640	(756)	2,884
Non-operating items[note (b)]	330	(1,203)	572	(301)	27	(274)
	1,394	125	1,820	3,339	(729)	2,610
Net cash flows to parent company[note (c)]	(645)	(475)	(668)	(1,788)	1,788	-
External dividends	-	-	-	-	(1,159)	(1,159)
Exchange rate movements, timing differences and other items[note (d)]	(421)	(140)	22	(539)	226	(313)
Net movement in free surplus	328	(490)	1,174	1,012	126	1,138
Balance at beginning of year	2,142	2,418	2,006	6,566	1,648	8,214
Balance at end of year	2,470	1,928	3,180	7,578	1,774	9,352

Notes

(a) Free surplus invested in new business primarily represents acquisition costs and amounts set aside for required capital.

(b) Non-operating items include short-term fluctuations in investment returns, the effect of changes in economic assumptions for long-term business operations and the effect of corporate transactions as described in note 17. In addition, for 2018 this includes the impact of a capital modelling enhancement in the UK and in the US changes to RBC factors following the US tax reform, which were formally approved by the National Association of Insurance Commissioners (NAIC) in June 2018. For 2017 this included the impact of US tax reform (see note 16).

(c) Net cash flows to parent company for long-term business operations reflect the flows as included in the holding company cash flow at transaction rates.

(d) Exchange rate movements, timing differences and other items represent:

	2018 £m					
	Asia operations	US operations	UK and Europe operations	Total insurance and asset management operations	Other operations	Group total
Exchange rate movements	**88**	**131**	**-**	**219**	**(6)**	**213**
Mark to market value movements on Jackson assets backing surplus and required capital	**-**	**(95)**	**-**	**(95)**	**-**	**(95)**
Other items[note (e)]	**(584)**	**(15)**	**239**	**(360)**	**1,511**	**1,151**
	(496)	**21**	**239**	**(236)**	**1,505**	**1,269**

	2017 £m					
	Asia operations	US operations	UK and Europe operations	Total insurance and asset management operations	Other operations	Group total
Exchange rate movements	(113)	(190)	6	(297)	(13)	(310)
Mark to market value movements on Jackson assets backing surplus and required capital	-	40	-	40	-	40
Other items[note (e)]	(308)	10	16	(282)	239	(43)
	(421)	(140)	22	(539)	226	(313)

(e) Other items include the effect of the net issuance of £1.2 billion of subordinated debt for other operations in 2018, intra-group loans and other intra-group transfers between operations and other non-cash items.

11 Expected transfer of value of in-force business and required capital to free surplus

The discounted value of in-force business and required capital for long-term business operations can be reconciled to the 2018 and 2017 total emergence of free surplus as follows:

	2018 £m	2017 £m
Required capital[note 9]	**9,848**	10,265
Value of in-force business (VIF)[note 9]	**33,013**	29,410
Add back: deduction for cost of time value of guarantees[note 9]	**2,427**	836
Other items*	**(2,169)**	(1,371)
Total long-term business operations	**43,119**	39,140

* 'Other items' represent amounts incorporated into VIF where there is no definitive timeframe for when the payments will be made or receipts received. In particular, other items include the deduction of the shareholders' interest in the with-profits estate, the value of which is derived by increasing final bonus rates so as to exhaust the estate over the lifetime of the in-force with-profits business. This is an assumption to give an appropriate valuation. To be conservative this item is excluded from the expected free surplus generation profile below.

Cash flows are projected on a deterministic basis and are discounted at the appropriate risk discount rate. The modelled cash flows use the same methodology underpinning the Group's EEV reporting and so are subject to the same assumptions and sensitivities.

The table below shows how the VIF generated by the in-force business and the associated required capital for long-term business operations is modelled as emerging into free surplus over future years.

		2018 £m Expected period of conversion of future post-tax distributable earnings and required capital flows to free surplus					
	2018 total as shown above	**1-5 years**	**6-10 years**	**11-15 years**	**16-20 years**	**21-40 years**	**40+ years**
Asia	**23,332**	**6,276**	**4,185**	**2,762**	**2,053**	**5,399**	**2,657**
US	**13,294**	**6,928**	**4,094**	**1,771**	**378**	**123**	**-**
UK and Europe	**6,493**	**2,616**	**1,713**	**1,053**	**633**	**476**	**2**
Total	**43,119**	**15,820**	**9,992**	**5,586**	**3,064**	**5,998**	**2,659**
	100%	**37%**	**23%**	**13%**	**7%**	**14%**	**6%**

		2017 £m Expected period of conversion of future post-tax distributable earnings and required capital flows to free surplus					
	2017 total as shown above	**1-5 years**	**6-10 years**	**11-15 years**	**16-20 years**	**21-40 years**	**40+ years**
Asia	18,692	5,583	3,638	2,418	1,655	3,845	1,553
US	12,455	6,247	3,993	1,697	401	117	-
UK and Europe	7,993	3,012	2,066	1,289	899	704	23
Total	39,140	14,842	9,697	5,404	2,955	4,666	1,576
	100%	38%	25%	14%	7%	12%	4%

12 Sensitivity of results to alternative assumptions

(i) Sensitivity analysis – economic assumptions

The tables below show the sensitivity of the embedded value as at 31 December 2018 and 31 December 2017 and the new business contribution after the effect of required capital for 2018 and 2017 for long-term business operations to:

— 1 per cent increase in the discount rates;
— 1 per cent increase in interest rates and risk discount rates, including consequential changes (assumed investment returns for all asset classes, market values of fixed interest assets);
— 0.5 per cent decrease in interest rates and risk discount rates, including consequential changes (assumed investment returns for all asset classes, market values of fixed interest assets);
— 1 per cent rise in equity and property yields;
— 10 per cent fall in market value of equity and property assets (embedded value only);
— The statutory minimum capital level in contrast to EEV basis required capital (embedded value only); and
— 5 basis points increase in UK long-term expected defaults.

In each sensitivity calculation, all other assumptions remain unchanged except where they are directly affected by the revised economic conditions.

New business contribution from long-term business operations

	2018 £m				2017 £m			
	Asia	**US**	**UK and Europe**	**Total**	**Asia**	**US**	**UK and Europe**	**Total**
New business contribution[note 3]	**2,604**	**921**	**352**	**3,877**	2,368	906	342	3,616
Discount rates – 1% increase	**(549)**	**(42)**	**(33)**	**(624)**	(477)	(34)	(48)	(559)
Interest rates – 1% increase	**(202)**	**94**	**43**	**(65)**	(103)	124	44	65
Interest rates – 0.5% decrease	**58**	**(66)**	**(23)**	**(31)**	(59)	(85)	(23)	(167)
Equity/property yields – 1% rise	**130**	**115**	**45**	**290**	130	130	52	312
Long-term expected defaults – 5 bps increase	**-**	**-**	**-**	**-**	-	-	(1)	(1)

Embedded value of long-term business operations

	31 Dec 2018 £m				31 Dec 2017 £m			
	Asia	**US**	**UK and Europe**	**Total**	**Asia**	**US**	**UK and Europe**	**Total**
Shareholders' equity[note 8]	**24,329**	**14,650**	**11,409**	**50,388**	20,947	13,257	11,713	45,917
Discount rates – 1% increase	**(3,292)**	**(513)**	**(648)**	**(4,453)**	(2,560)	(440)	(774)	(3,774)
Interest rates – 1% increase	**(1,564)**	**119**	**(668)**	**(2,113)**	(944)	26	(635)	(1,553)
Interest rates – 0.5% decrease	**366**	**(273)**	**363**	**456**	121	(166)	384	339
Equity/property yields – 1% rise	**1,041**	**1,011**	**377**	**2,429**	873	896	425	2,194
Equity/property market values – 10% fall	**(473)**	**(498)**	**(461)**	**(1,432)**	(429)	(209)	(479)	(1,117)
Statutory minimum capital	**110**	**217**	**-**	**327**	169	158	-	327
Long-term expected defaults – 5 bps increase	**-**	**-**	**(76)**	**(76)**	-	-	(135)	(135)

The sensitivities shown above are for the impact of instantaneous changes on the embedded value of long-term business operations and include the combined effect on the value of in-force business and net assets at the balance sheet dates indicated. If the change in assumptions shown in the sensitivities were to occur, then the effect shown above would be recorded within two components of the profit analysis for the following year, namely the effect of economic assumption changes and short-term fluctuations in investment returns. In addition to the sensitivity effects shown above, the other components of the profit for the following year would be calculated by reference to the altered assumptions, for example new business contribution and unwind of discount, together with the effect of other changes such as altered corporate bond spreads. In addition for changes in interest rates, the effect shown above for Jackson would also be recorded within the fair value movements on assets backing surplus and required capital, which are taken directly to shareholders' equity.

(ii) Sensitivity analysis – non-economic assumptions

The tables below show the sensitivity of the embedded value as at 31 December 2018 and 31 December 2017 and the new business contribution after the effect of required capital for 2018 and 2017 for long-term business operations to:

- 10 per cent proportionate decrease in maintenance expenses (for example a 10 per cent sensitivity on a base assumption of £10 per annum would represent an expense assumption of £9 per annum);
- 10 per cent proportionate decrease in lapse rates (for example a 10 per cent sensitivity on a base assumption of 5 per cent would represent a lapse rate of 4.5 per cent per annum); and
- 5 per cent proportionate decrease in base mortality and morbidity rates (ie increased longevity).

New business contribution from long-term business operations

	2018 £m				2017 £m			
	Asia	US	UK and Europe	Total	Asia	US	UK and Europe	Total
New business contribution[note 3]	**2,604**	**921**	**352**	**3,877**	2,368	906	342	3,616
Maintenance expenses – 10% decrease	**40**	**11**	**2**	**53**	38	14	3	55
Lapse rates – 10% decrease	**154**	**24**	**17**	**195**	133	24	20	177
Mortality and morbidity – 5% decrease	**70**	**4**	**1**	**75**	69	4	(2)	71

Embedded value of long-term business operations

	31 Dec 2018 £m				31 Dec 2017 £m			
	Asia	US	UK and Europe	Total	Asia	US	UK and Europe	Total
Shareholders' equity[note 8]	**24,329**	**14,650**	**11,409**	**50,388**	20,947	13,257	11,713	45,917
Maintenance expenses – 10% decrease	**254**	**178**	**80**	**512**	213	169	64	446
Lapse rates – 10% decrease	**972**	**619**	**87**	**1,678**	753	659	64	1,476
Mortality and morbidity – 5% decrease	**835**	**141**	**(294)**	**682**	668	214	(442)	440
Change representing effect on:								
Life business	**835**	**196**	**13**	**1,044**	668	214	13	895
Annuities	**-**	**(55)**	**(307)**	**(362)**	-	-	(455)	(455)

13 Methodology and accounting presentation

(i) Methodology

Overview

The embedded value is the present value of the shareholders' interest in the earnings distributable from assets allocated to covered business after sufficient allowance has been made for the aggregate risks in that business. The shareholders' interest in the Group's long-term business comprises:

- The present value of future shareholder cash flows from in-force covered business (value of in-force business), less deductions for:
  - The cost of locked-in required capital; and
  - The time value of cost of options and guarantees;
- Locked-in required capital; and
- The shareholders' net worth in excess of required capital (free surplus).

The value of future new business is excluded from the embedded value.

Notwithstanding the basis of presentation of results as explained in note 13(ii)(c), no smoothing of market or account balance values, unrealised gains or investment return is applied in determining the embedded value or profit. Separately, the analysis of profit is delineated between operating profit based on longer-term investment returns and other constituent items, as explained in note 13(ii)(a).

(a) Covered business

The EEV results for the Group are prepared for 'covered business', as defined by the EEV Principles. Covered business represents the Group's long-term insurance business, including the Group's investments in joint venture and associate insurance operations, for which the value of new and in-force contracts is attributable to shareholders. The post-tax EEV basis results for the Group's covered business are then combined with the post-tax IFRS basis results of the Group's asset management and other operations (including Group and Asia Regional Head Office, holding company borrowings, Africa operations and Prudential Capital). Under the EEV Principles, the results for covered business incorporate the projected margins of attaching internal asset management, as described in note 13(i)(g).

The definition of long-term business operations comprises those contracts falling under the definition for regulatory purposes together with, for US operations, contracts that are in substance the same as guaranteed investment contracts (GICs) but do not fall within the technical definition.

Covered business comprises the Group's long-term business operations, with two exceptions:

- The closed Scottish Amicable Insurance Fund (SAIF) which is excluded from covered business. SAIF is a ring-fenced sub-fund of The Prudential Assurance Company Limited (PAC) long-term fund, established by a Court Approved Scheme of Arrangement in October 1997. SAIF is closed to new business and the assets and liabilities of the fund are wholly attributable to the policyholders of the fund; and
- The presentational treatment of the Group's principal defined benefit pension scheme, the Prudential Staff Pension Scheme (PSPS). The partial recognition of the surplus for PSPS is recognised in 'Other' operations.

A small amount of UK group pensions business is also not modelled for EEV reporting purposes.

(b) Valuation of in-force and new business

The embedded value results are prepared incorporating best estimate assumptions about all relevant factors including levels of future investment returns, expenses, persistency, mortality and morbidity, as described in note 14(vii). These assumptions are used to project future cash flows. The present value of the future cash flows is then calculated using a discount rate which reflects both the time value of money and the non-diversifiable risks associated with the cash flows that are not otherwise allowed for.

New business

In determining the EEV basis value of new business, premiums are included in projected cash flows on the same basis of distinguishing annual and single premium business as set out for statutory basis reporting.

New business premiums reflect those premiums attaching to covered business, including premiums for contracts classified as investment products for IFRS basis reporting. New business premiums for regular premium products are shown on an annualised basis. Internal vesting business is classified as new business where the contracts include an open market option.

The post-tax contribution from new business represents profits determined by applying operating and economic assumptions as at the end of the year. New business profitability is a key metric for the Group's management of the development of the business. In addition, post-tax new business margins are shown by reference to annual premium equivalents (APE) and the present value of new business premiums (PVNBP). These margins are calculated as the percentage of the value of new business profit to APE and PVNBP. APE is calculated as the aggregate of regular premiums on new business written in the period and one-tenth of single premiums. PVNBP is calculated as the aggregate of single premiums and the present value of expected future premiums from regular premium new business, allowing for lapses and the other assumptions made in determining the EEV new business contribution.

Valuation movements on investments

With the exception of debt securities held by Jackson, investment gains and losses during the year (to the extent that changes in capital values do not directly match changes in liabilities) are included directly in the profit for the year and shareholders' equity as they arise.

The results for any covered business conceptually reflect the aggregate of the IFRS results and the movements on the additional shareholders' interest recognised on the EEV basis. Thus the start point for the calculation of the EEV results for Jackson, as for other businesses, reflects the market value movements recognised on an IFRS basis.

However, in determining the movements on the additional shareholders' interest, the basis for calculating the EEV result for Jackson acknowledges that, for debt securities backing liabilities, the aggregate EEV results reflect the fact that the value of in-force business instead incorporates the discounted value of future spread earnings. This value is not affected generally by short-term market movements on securities that, broadly speaking, are held for the longer term.

Fixed income securities backing the free surplus and required capital for Jackson are accounted for at fair value. However, consistent with the treatment applied under IFRS for Jackson securities classified as available-for-sale, movements in unrealised appreciation/depreciation on these securities are accounted for in equity rather than in the income statement, as shown in the movement in shareholders' equity.

(c) Cost of capital

A charge is deducted from the embedded value for the cost of locked-in required capital supporting the Group's long-term business. The cost is the difference between the nominal value of the capital and the discounted value of the projected releases of this capital, allowing for post-tax investment earnings on the capital.

The annual result is affected by the movement in this cost from year to year which comprises a charge against new business profit and generally a release in respect of the reduction in capital requirements for business in force as this runs off.

Where required capital is held within a with-profits long-term fund, the value placed on surplus assets in the fund is already discounted to reflect its expected release over time and no further adjustment is necessary in respect of required capital.

(d) Financial options and guarantees

Nature of financial options and guarantees in Prudential's long-term business

Asia

Subject to local market circumstances and regulatory requirements, the guarantee features described below in respect of UK and Europe business broadly apply to similar types of participating contracts in Asia which are principally written in Hong Kong, Singapore and Malaysia. Participating products have both guaranteed and non-guaranteed elements.

There are also various non-participating long-term products with guarantees. The principal guarantees are those for whole-of-life contracts with floor levels of policyholder benefits that accrue at rates set at inception and do not vary subsequently with market conditions.

US (Jackson)

The principal financial options and guarantees in Jackson are associated with the fixed annuity (FA) and variable annuity (VA) lines of business.

Fixed annuities provide that, at Jackson's discretion, it may reset the interest rate credited to policyholders' accounts, subject to a guaranteed minimum. The guaranteed minimum return varies from 1.0 per cent to 5.5 per cent for both years, depending on the particular product, jurisdiction where issued, and date of issue. At 31 December 2018, 88 per cent of the account values on fixed annuities are for policies with guarantees of 3 per cent or less (31 December 2017: 87 per cent), and the average guarantee rate is 2.6 per cent for both years.

Fixed annuities also present a risk that policyholders will exercise their option to surrender their contracts in periods of rapidly rising interest rates, possibly requiring Jackson to liquidate assets at an inopportune time.

Jackson issues variable annuity (VA) contracts for which it contractually guarantees to the contract holder, subject to specific conditions, either: a) return of no less than total deposits made to the contract adjusted for any partial withdrawals; b) total deposits made to the contract adjusted for any partial withdrawals plus a minimum return; or c) the highest contract value on a specified anniversary date adjusted for any withdrawals following the specified contract anniversary. These guarantees include benefits that are payable upon depletion of funds (Guaranteed Minimum Withdrawal Benefit (GMWB)), as death benefits (Guaranteed Minimum Death Benefits (GMDB)) or as income benefits (Guaranteed Minimum Income Benefits (GMIB)). These guarantees generally protect the policyholders' value in the event of poor equity market performance. Jackson hedges the GMWB and GMDB guarantees through the use of equity options and futures contracts, and essentially fully reinsures the GMIB guarantees.

Jackson also issues fixed index annuities (FIA) that enable policyholders to obtain a portion of an equity-linked return while providing a guaranteed minimum return. The guaranteed minimum returns are of a similar nature to those described above for fixed annuities.

UK and Europe (M&GPrudential)

The only significant financial options and guarantees in M&GPrudential's covered business arise in the with-profits fund.

With-profits products provide returns to policyholders through bonuses that are smoothed. There are two types of bonuses: annual and final. Annual bonuses are declared once a year and, once credited, are guaranteed in accordance with the terms of the particular product. Final bonuses are guaranteed only until the next bonus declaration. The UK with-profits fund also held a provision of £49 million at 31 December 2018 (31 December 2017: £53 million) to honour guarantees on a small number of guaranteed annuity option products.

The Group's main exposure to guaranteed annuity options in M&GPrudential is through the non-covered business of SAIF. A provision of £361 million was held in SAIF at 31 December 2018 (31 December 2017: £503 million) to honour the guarantees. As described in note 13 (i)(a), the assets and liabilities are wholly attributable to the policyholders of the fund. Therefore the movement in the provision has no direct impact on shareholders' funds.

Time value
The value of financial options and guarantees comprises two parts:

— The first part arises from a deterministic valuation on best estimate assumptions (the intrinsic value); and
— The second part arises from the variability of economic outcomes in the future (the time value).

Where appropriate, a full stochastic valuation has been undertaken to determine the time value of the financial options and guarantees.

The economic assumptions used for the stochastic calculations are consistent with those used for the deterministic calculations. Assumptions specific to the stochastic calculations reflect local market conditions and are based on a combination of actual market data, historic market data and an assessment of long-term economic conditions. Common principles have been adopted across the Group for the stochastic asset models, for example, separate modelling of individual asset classes but with an allowance for correlation between the various asset classes. Details of the key characteristics of each model are given in notes 14(iv), (v) and (vi).

In deriving the time value of financial options and guarantees, management actions in response to emerging investment and fund solvency conditions have been modelled. Management actions encompass, but are not confined to, investment allocation decisions, levels of reversionary and terminal bonuses and credited rates. Bonus rates are projected from current levels and varied in accordance with assumed management actions applying in the emerging investment and fund solvency conditions.

In all instances, the modelled actions are in accordance with approved local practice and therefore reflect the options actually available to management. For the UK with-profits fund, the actions assumed are consistent with those set out in the Principles and Practices of Financial Management which explains how regular and final bonus rates within the discretionary framework are determined, subject to the general legislative requirements applicable.

(e) Level of required capital
In adopting the EEV Principles, Prudential has based required capital on the applicable local statutory regulations, including any amounts considered to be required above the local statutory minimum requirements to satisfy regulatory constraints.

For with-profits business in Asia and the UK, the available capital in the fund is sufficient to meet the capital requirements. For M&GPrudential, a portion of future shareholder transfers expected from the with-profits fund is recognised within net worth, together with the associated capital requirements.

For shareholder-backed business, the following capital requirements for long-term business operations apply:

— Asia: the level of required capital has been set to an amount at least equal to local statutory notification requirements. For China operations, the level of required capital follows the approach for embedded value reporting issued by the China Association of Actuaries (CAA) reflecting the C-ROSS regime;
— US: the level of required capital has been set at 250 per cent of the risk-based capital (RBC) required by the National Association of Insurance Commissioners (NAIC) at the Company Action Level (CAL); and
— UK and Europe: the capital requirements are set at the Solvency II Solvency Capital Requirement (SCR) for shareholder-backed business as a whole. Following the announced demerger, from 1 January 2018 this does not allow for diversification outside the planned perimeter of the business to be demerged.

(f) With-profits business and the treatment of the estate
The proportion of surplus allocated to shareholders from the UK with-profits fund has been based on the present level of 10 per cent. The value attributed to the shareholders' interest in the estate is derived by increasing final bonus rates (and related shareholder transfers) so as to exhaust the estate over the lifetime of the in-force with-profits business. In any scenarios where the total assets of the life fund are insufficient to meet policyholder claims in full, the excess cost is fully attributed to shareholders. Similar principles apply, where appropriate, for other with-profits funds of the Group's Asia operations.

(g) Internal asset management
The in-force and new business results from long-term business include the projected value of profits or losses from asset management and service companies that support the Group's covered insurance businesses. The results of the Group's asset management operations include the current year profits from the management of both internal and external funds. EEV basis shareholders' other income and expenditure is adjusted to deduct the unwind of the expected internal asset management profit margin for the year as included in 'Other operations'. The deduction is on a basis consistent with that used for projecting the results for covered insurance business. Group operating profit accordingly includes the variance between actual and expected profit in respect of management of the assets for covered business.

(h) Allowance for risk and risk discount rates

Overview
Under the EEV Principles, discount rates used to determine the present value of future cash flows are set by reference to risk-free rates plus a risk margin.

For Asia and the US, the risk-free rates are based on 10-year local government bond yields. For UK and Europe, the EEV risk-free rate is based on the full term structure of interest rates, ie a yield curve, which is used to determine the embedded value at the end of the reporting period.

The risk margin should reflect any non-diversifiable risk associated with the emergence of distributable earnings that is not allowed for elsewhere in the valuation. In order to better reflect differences in relative market risk volatility inherent in each product group, Prudential sets the risk discount rates to reflect the expected volatility associated with the cash flows for each product category in the embedded value model, rather than at a Group level.

Since financial options and guarantees are explicitly valued under the EEV methodology, risk discount rates under EEV are set excluding the effect of these product features.

The risk margin represents the aggregate of the allowance for market risk, additional allowance for credit risk where appropriate, and allowance for non-diversifiable non-market risk. No allowance is required for non-market risks where these are assumed to be fully diversifiable.

Market risk allowance
The allowance for market risk represents the beta multiplied by an equity risk premium. Except for UK shareholder-backed annuity business (as explained below), such an approach has been used for the Group's businesses.

The beta of a portfolio or product measures its relative market risk. The risk discount rates reflect the market risk inherent in each product group and hence the volatility of product cash flows. These are determined by considering how the profits from each product are affected by changes in expected returns on various asset classes. By converting this into a relative rate of return, it is possible to derive a product-specific beta.

Product level betas reflect the most recent product mix to produce appropriate betas and risk discount rates for each major product grouping.

Additional credit risk allowance
The Group's methodology is to allow appropriately for credit risk. The allowance for total credit risk is to cover:

— Expected long-term defaults;
— Credit risk premium (to reflect the volatility in downgrade and default levels); and
— Short-term downgrades and defaults.

These allowances are initially reflected in determining best estimate returns and through the market risk allowance described above. However, for those businesses largely backed by holdings of debt securities, these allowances in the projected returns and market risk allowances may not be sufficient and an additional allowance may be appropriate.

The practical application of the allowance for credit risk varies depending upon the type of business as described below:

Asia
For Asia, the allowance for credit risk incorporated in the projected rates of return and the market risk allowance are considered to be sufficient. Accordingly, no additional allowance for credit risk is required.

The projected rates of return for holdings of corporate bonds comprise the risk-free rate plus an assessment of long-term spread over the risk-free rate.

US (Jackson)
For Jackson business, the allowance for long-term defaults of 0.17 per cent (31 December 2017: 0.19 per cent) is reflected in the risk margin reserve (RMR) charge that is deducted in determining the projected spread margin between the earned rate on the investments and the policyholder crediting rate.

The risk discount rate incorporates an additional allowance for credit risk premium and short-term downgrades and defaults (0.2 per cent for variable annuity business and 1.0 per cent for non-variable annuity business for both years), as shown in note 14(ii). In determining this allowance a number of factors have been considered. These factors, in particular, include:

— How much of the credit spread on debt securities represents an increased short-term credit risk not reflected in the RMR long-term default assumptions, and how much is liquidity premium (which is the premium required by investors to compensate for the risk of longer-term investments which cannot be easily converted into cash at the fair market value). In assessing this effect, consideration has been given to a number of approaches to estimating the liquidity premium by considering recent statistical data; and
— Policyholder benefits for Jackson fixed annuity business are not fixed. It is possible in adverse economic scenarios to pass on a component of credit losses to policyholders (subject to guarantee features) through lower investment returns credited to policyholders. Consequently, it is only necessary to allow for the balance of the credit risk in the risk discount rate.

The level of the additional allowance is assessed at each reporting period to take account of prevailing credit conditions and as the business in force alters over time. The additional allowance for variable annuity business has been set at one-fifth of the non-variable annuity business to reflect the proportion of the allocated holdings of general account debt securities.

The level of allowance differs from that for UK annuity business for investment portfolio differences and to take account of the management actions available in adverse economic scenarios to reduce crediting rates to policyholders, subject to guarantee features of the products.

UK and Europe (M&GPrudential)
(1) Shareholder-backed annuity business
For shareholder-backed annuity business, Prudential has used a market consistent embedded value (MCEV) approach to derive an implied risk discount rate which is then applied to the projected best estimate cash flows.

In the annuity MCEV calculations, as the assets are generally held to maturity to match liabilities, the future cash flows are discounted using the swap yield curve plus an allowance for liquidity premium based on the Solvency II allowance for credit risk. The Solvency II allowance is set by the European Insurance and Occupational Pensions Authority (EIOPA) using a prudent assumption that all future downgrades will be replaced annually, and allowing for the credit spread floor.

For the purposes of presentation in the EEV results, the results produced on this basis are reconfigured. Under this approach the projected earned rate of return on the debt securities held is determined after allowing for a best estimate credit risk allowance. The remaining elements of prudence within the Solvency II allowance are incorporated into the risk margin included in the discount rate, shown in note 14(iii).

(2) With-profits fund non-profit annuity business
For non-profit annuity business attributable to the UK with-profits fund, the basis for determining the aggregate allowance for credit risk is consistent with that applied for UK shareholder-backed annuity business (as described above). The allowance for credit risk for this business is taken into account in determining the projected cash flows from the with-profits fund, which are in turn discounted at the risk discount rate applicable to all of the projected cash flows from the fund.

(3) With-profits fund holdings of debt securities
The with-profits fund holds debt securities as part of its investment portfolio backing policyholder liabilities and unallocated surplus. The assumed earned rate for with-profit holdings of corporate bonds is defined as the risk-free rate plus an assessment of the long-term spread over riskfree, net of expected long-term defaults. This approach is similar to that applied for equities and properties for which the projected earned rate is defined as the risk-free rate plus a long-term risk premium.

Allowance for non-diversifiable non-market risks
The majority of non-market and non-credit risks are considered to be diversifiable. An allowance for non-diversifiable non-market risks is estimated as set out below:

A base level allowance of 50 basis points is applied to cover the non-diversifiable non-market risks associated with the Group's businesses. For the Group's Asia operations in Indonesia, the Philippines, Taiwan, Thailand and Vietnam, additional allowances are applied for emerging market risk ranging from 100 to 250 basis points. The level of these allowances are reviewed and updated based on an assessment of a range of pre-defined emerging market risk indicators, as well as the Group's exposure and experience in the business units. At 31 December 2018, the China allowance for non-market risk was reduced reflecting the growth in the size of the business, increasing management exposure and experience in the country and an improvement in our risk assessment of the market. For the Group's US business and UK and Europe business, no additional allowance is necessary.

(i) Foreign currency translation
Foreign currency profits and losses have been translated at average exchange rates for the year. Foreign currency assets and liabilities have been translated at year-end exchange rates. The principal exchange rates are shown in note A1 of the IFRS financial statements.

(j) Taxation
In determining the post-tax profit for the year for covered business, the overall tax rate includes the impact of tax effects determined on a local regulatory basis. Tax payments and receipts included in the projected cash flows to determine the value of in-force business are calculated using rates that have been announced and substantively enacted by the end of the reporting period.

(k) Inter-company arrangements
The EEV results for covered business incorporate annuities established in the PAC non-profit sub-fund from vesting pension policies in SAIF (which is not covered business). The EEV results also incorporate the effect of the reinsurance arrangement of non-profit immediate pension annuity liabilities of SAIF to the PAC non-profit sub-fund.

(ii) Accounting presentation

(a) Analysis of post-tax profit
To the extent applicable, the presentation of the EEV post-tax profit for the year is consistent with the classification between operating and non-operating results with the basis that the Group applies for the analysis of IFRS basis results. Operating results reflect underlying results including longer-term investment returns, which are determined as described in note 13(ii)(b) and incorporate the following:

— New business contribution, as defined in note 13(i)(b);
— Unwind of discount on the value of in-force business and other expected returns, as described in note 13(ii)(c);
— The impact of routine changes of estimates relating to operating assumptions, as described in note 13(ii)(d); and
— Operating experience variances, as described in note 13(ii)(e).

Non-operating results comprise:

— Short-term fluctuations in investment returns;
— The mark to market value movements on core structural borrowings;
— The effect of changes in economic assumptions; and
— The impact of corporate transactions undertaken in the year.

In addition, operating results include the effect of changes in tax legislation, unless these changes are one-off and structural in nature, such as the impact of the US tax reform in 2017 (see note 16), or primarily affect the level of projected investment returns, in which case they are reflected as a non-operating result.

Total profit attributable to shareholders and basic earnings per share include these items, together with actual investment returns. The Group believes that operating profit, as adjusted for these items, better reflects underlying performance.

For M&GPrudential, the embedded value incorporates Solvency II transitional measures, which are recalculated using management's estimate of the impact of operating and market conditions at the valuation date. The impact of this recalculation is recorded within the corresponding component of the analysis of post-tax profit.

(b) Investment returns included in operating profit
For the investment element of the assets covering the net worth of long-term insurance business, investment returns are recognised in operating results at the expected long-term rate of return. These expected returns are calculated by reference to the asset mix of the portfolio. For the purpose of calculating the longer-term investment return to be included in the operating result of the with-profits fund of M&GPrudential, where assets backing the liabilities and unallocated surplus are subject to market volatility, asset values at the beginning of the reporting period are adjusted to remove the effects of short-term market movements as explained in note 13(ii)(c).

For the purpose of determining the long-term returns for debt securities of US operations for fixed annuity and other general account business, a risk margin reserve charge is included which reflects the expected long-term rate of default based on the credit quality of the portfolio. For Jackson, interest-related realised gains and losses are amortised to the operating results over the maturity period of the sold bonds and for equity-related investments, a long-term rate of return is assumed, which reflects the aggregation of end-of-period risk-free rates and the equity risk premium. For US variable annuity separate account business, operating profit includes the unwind of discount on the opening value of in-force business adjusted to reflect end-of-period projected rates of return with the excess or deficit of the actual return recognised within non-operating profit, together with related hedging activity.

For UK annuity business, rebalancing of the asset portfolio backing the liabilities to policyholders may, from time to time, take place to align it more closely with the internal benchmark of credit quality that management applies. Such rebalancing will result in a change in the projected yield on the asset portfolio and the allowance for default risk. The net effect of these changes is included in the operating result for the year.

(c) Unwind of discount and other expected returns
The Group's methodology in determining the unwind of discount and other expected returns is by reference to:

- The value of in-force business at the beginning of the year (adjusted for the effect of current year economic and operating assumption changes); and
- Required capital and surplus assets.

In applying this general approach, the unwind of discount included in operating profit for M&GPrudential is described below.

M&GPrudential
The unwind is determined by reference to an implied single risk discount rate. The EEV risk-free rate is based on a yield curve (as set out in note 13(i)(h)), which is used to derive an implied single discount rate which, if this rate had been used, would reproduce the same embedded value as that calculated by reference to the yield curve. The difference between the operating profit determined using the single implied discount rate and that derived using the yield curve is included within non-operating profit.

For with-profits business, the opening value of in-force is adjusted for the effect of short-term investment volatility due to market movements (ie smoothed). In the summary statement of financial position and for total profit reporting, asset values and investment returns are not smoothed. At 31 December 2018, the shareholders' interest in the smoothed surplus assets used for this purpose only were £12 million higher (31 December 2017: £57 million lower) than the surplus assets carried in the statement of financial position.

(d) Effect of changes in operating assumptions
Operating profit includes the effect of changes to non-economic assumptions on the value of in-force at the end of the year. For presentational purposes the effect of changes is delineated to show the effect on the opening value of in-force as operating assumption changes, with the experience variances subsequently being determined by reference to the end-of-year assumptions (see note 13(ii)(e)).

(e) Operating experience variances
Operating profit includes the effect of experience variances on non-economic assumptions, such as persistency, mortality and morbidity, expenses and other factors, which are calculated with reference to the end-of-year assumptions.

(f) Effect of changes in economic assumptions
Movements in the value of in-force business at the beginning of the year caused by changes in economic assumptions, net of the related change in the time value of cost of options and guarantees, are recorded in non-operating results.

14 Assumptions

Principal economic assumptions

The EEV basis results for the Group's operations have been determined using economic assumptions where the long-term expected rates of return on investments and risk discount rates are set by reference to year-end risk-free rates of return (defined below for each of the Group's insurance operations). Expected returns on equity and property asset classes and corporate bonds are derived by adding a risk premium, based on the Group's long-term view, to the risk-free rate.

The total profit that emerges over the lifetime of an individual contract as calculated using the embedded value basis is the same over time as that calculated under the IFRS basis. Since the embedded value basis reflects discounted future cash flows, under the EEV methodology the profit emergence is advanced, thus more closely aligning the timing of the recognition of profit with the efforts and risks of current management actions, particularly with regard to business sold during the year.

(i) Asia

The risk-free rates of return for Asia are defined as 10-year government bond yields at the end of the year.

	Risk discount rate %				10-year government bond yield %		Expected long-term Inflation %	
	New business		In-force business					
	31 Dec 2018	31 Dec 2017	31 Dec 2018	31 Dec 2017	31 Dec 2018	31 Dec 2017	31 Dec 2018	31 Dec 2017
China	**8.1**	9.7	**8.1**	9.7	**3.3**	3.9	**3.0**	3.0
Hong Kong[notes (b)(d)]	**4.4**	4.1	**4.4**	4.1	**2.7**	2.4	**2.5**	2.5
Indonesia	**12.4**	10.6	**12.4**	10.6	**8.2**	6.4	**4.5**	4.5
Malaysia[note (d)]	**6.6**	6.4	**6.6**	6.5	**4.1**	3.9	**2.5**	2.5
Philippines	**14.5**	12.7	**14.5**	12.7	**7.0**	5.2	**4.0**	4.0
Singapore[note (d)]	**3.4**	3.5	**4.2**	4.4	**2.1**	2.0	**2.0**	2.0
Taiwan	**4.5**	4.3	**4.4**	3.9	**0.9**	0.9	**1.5**	1.5
Thailand	**10.0**	9.8	**10.0**	9.8	**2.5**	2.3	**3.0**	3.0
Vietnam	**12.6**	12.6	**12.6**	12.6	**5.1**	5.1	**5.5**	5.5
Total weighted risk discount rate[note (a)]	**5.4**	5.3	**5.8**	5.7				

Notes

(a) The weighted risk discount rates for Asia operations shown above have been determined by weighting each market's risk discount rates by reference to the post-tax EEV basis new business contribution and the closing value of in-force business. The changes in the risk discount rates for individual Asia business units reflect the movements in 10-year government bond yields, changes in the economic basis and changes in product mix.

(b) For Hong Kong the assumptions shown are for US dollar denominated business. For other business units, the assumptions are for local currency denominated business.

(c) Equity risk premiums in Asia range from 4.0 per cent to 9.4 per cent (2017: 4.0 per cent to 9.4 per cent).

(d) The mean equity return assumptions for the most significant equity holdings of the Asia operations are:

	31 Dec 2018 %	31 Dec 2017 %
Hong Kong	**6.7**	6.4
Malaysia	**10.6**	10.4
Singapore	**8.6**	8.5

(ii) US
The risk-free rates of return for the US are defined as the 10-year treasury bond yield at the end of the year.

	31 Dec 2018 %	31 Dec 2017 %
Risk discount rate:		
Variable annuity:		
Risk discount rate	**7.1**	6.8
Additional allowance for credit risk included in risk discount rate[note 13(i)(h)]	**0.2**	0.2
Non-variable annuity:		
Risk discount rate	**4.4**	4.1
Additional allowance for credit risk included in risk discount rate[note 13(i)(h)]	**1.0**	1.0
Weighted average total:		
New business	**6.9**	6.7
In-force business	**6.8**	6.5
US 10-year treasury yield	**2.7**	2.4
Allowance for long-term defaults included in projected spread[note 13(i)(h)]	**0.17**	0.19
Pre-tax expected long-term nominal rate of return for US equities	**6.7**	6.4
Expected long-term rate of inflation	**2.9**	3.0
Equity risk premium	**4.0**	4.0
S&P equity return volatility	**17.5**	18.0

Note
Assumed new business spread margins are as follows:

	31 Dec 2018 %		31 Dec 2017 %	
	January to June issues	July to December issues	January to June issues	July to December issues
Fixed annuity business*†	**1.75**	**1.75**	1.50	1.25
Fixed index annuity business*	**2.00**	**2.00**	1.75	1.50
Institutional business	**0.50**	**0.50**	0.50	0.50

* The assumed spread margin grades up linearly by 25 basis points to a long-term assumption over five years.
† Including the proportion of variable annuity business invested in the general account.

(iii) UK and Europe
The risk-free rate is based on the full term structure of interest rates, ie a yield curve, which is used to determine the embedded value at the end of the reporting period. These yield curves are used to derive pre-tax expected long-term nominal rates of investment return and risk discount rates. For the purpose of determining the unwind of discount in the analysis of operating profit, these yield curves are used to derive a single implied risk discount rate, as explained in note 13(i)(h).

This single implied risk discount rate is shown, along with the 15-year nominal rate of investment return and 15-year rate of inflation based on the inflation yield curve.

	31 Dec 2018 %	31 Dec 2017 %
Shareholder-backed annuity in-force business:[note (a)]		
Risk discount rate	**4.7**	4.0
Pre-tax expected 15-year nominal rates of investment return[note (c)]	**3.1**	2.6
With-profits and other business:		
Risk discount rate:[note (b)]		
New business	**4.9**	4.7
In-force business	**5.0**	4.8
Pre-tax expected 15-year nominal rates of investment return:[note (c)]		
Overseas equities	**6.5 to 10.1**	6.2 to 10.1
Property	**4.4**	4.4
15-year gilt yield	**1.7**	1.6
Corporate bonds	**3.5**	3.4
Expected 15-year rate of inflation	**3.6**	3.5
Equity risk premium	**4.0**	4.0

Notes
(a) For shareholder-backed annuity business, the movements in the pre-tax long-term nominal rates of return and risk discount rates reflect the effect of changes in asset yields.
(b) The risk discount rates for with-profits and other business shown above represents a weighted average total of the rates applied to determine the present value of future cash flows, including the portion of future with-profits business shareholders' transfers recognised in net worth.
(c) The table below shows the pattern of the UK risk-free Solvency II spot yield curve at the end of 31 December:

	1 year	5 year	10 year	15 year	20 year
31 Dec 2018	**1.0%**	**1.2%**	**1.3%**	**1.4%**	**1.5%**
31 Dec 2017	0.6%	0.9%	1.2%	1.3%	1.4%

Stochastic assumptions
Details are given below of the key characteristics of the models used to determine the time value of the financial options and guarantees as referred to in note 13(i)(d).

(iv) Asia
— The stochastic cost of guarantees is primarily of significance for the Hong Kong, Malaysia, Singapore and Taiwan operations;
— The principal asset classes are government and corporate bonds;
— The asset return models are similar to the models as described for M&GPrudential below; and

— The volatility of equity returns ranges from 18 per cent to 35 per cent for both years, and the volatility of government bond yields ranges from 1.1 per cent to 2.0 per cent (2017: from 1.1 per cent to 2.0 per cent).

(v) US (Jackson)

— Interest rates and equity returns are projected using a log-normal generator reflecting historical market data;
— Corporate bond returns are based on treasury yields plus a spread that reflects current market conditions; and
— The volatility of equity returns ranges from 17 per cent to 26 per cent (2017: from 18 per cent to 27 per cent), and the standard deviation of interest rates ranges from 3.4 per cent to 3.7 per cent (2017: from 2.5 per cent to 2.8 per cent).

(vi) UK and Europe (M&GPrudential)

— Interest rates are projected using a stochastic interest rate model calibrated to the current market yields;
— Equity returns are assumed to follow a log-normal distribution;
— The corporate bond return is calculated based on a risk-free return plus a mean-reverting spread;
— Property returns are also modelled based on a risk-free return plus a risk premium with a stochastic process reflecting total property returns; and
— The standard deviation of equities and property ranges from 14 per cent to 20 per cent for both years.

Operating assumptions

(vii) Best estimate assumptions

Best estimate assumptions are used for the cash flow projections, where best estimate is defined as the mean of the distribution of future possible outcomes. The assumptions are reviewed actively and changes are made when evidence exists that material changes in future experience are reasonably certain.

Assumptions required in the calculation of the value of options and guarantees, for example relating to volatilities and correlations, or dynamic algorithms linking liabilities to assets, have been set equal to the best estimates and, wherever material and practical, reflect any dynamic relationships between the assumptions and the stochastic variables.

Demographic assumptions

Persistency, mortality and morbidity assumptions are based on an analysis of recent experience, but also reflect expected future experience. Where relevant, when calculating the time value of financial options and guarantees, policyholder withdrawal rates vary in line with the emerging investment conditions according to management's expectations. When projecting cash flows for medical reimbursement business that is repriced annually, explicit allowance is made for expected future premiums inflation and separately for future medical claims inflation. The 2018 EEV results reflect this approach. Previously, medical claims inflation was implicitly allowed for by assuming that all increases in medical claim costs were directly offset by future premium increases with no impact on profits.

Expense assumptions

Expense levels, including those of service companies that support the Group's long-term business operations, are based on internal expense analysis and are appropriately allocated to acquisition of new business and renewal of in-force business. For mature business, it is Prudential's policy not to take credit for future cost reduction programmes until the actions to achieve the savings have been delivered. An allowance is made for short-term required expenses, that are not representative of the longer-term expense loadings of the relevant businesses. At 31 December 2018, the allowance held for these costs across the Group was £(436) million mainly arising in Asia. Expense overruns are reported where these are expected to be short-lived, including businesses that are growing rapidly or are sub-scale.

For Asia operations, the expenses comprise costs borne directly and recharged costs from the Asia Regional Head Office that are attributable to covered business. The assumed future expenses for these operations also include projections of these future recharges. Development expenses are charged as incurred.

Corporate expenditure, which is included in other income and expenditure, comprises:

— Expenditure for Group Head Office, to the extent not allocated to the UK with-profits funds, together with restructuring costs incurred across the group; and
— Expenditure of the Asia Regional Head Office that is not allocated to the covered business or asset management operations which is charged as incurred. These costs are primarily for corporate related activities and are included within corporate expenditure.

(viii) Tax rates

The assumed long-term effective tax rates for operations reflect the incidence of taxable profits and losses in the projected cash flows as explained in note 13(i)(j).

The local statutory corporate tax rates applicable for the most significant operations for 2018 and 2017 are as follows:

	%
Asia operations:	
Hong Kong	16.5 per cent on 5 per cent of premium income
Indonesia	25.0
Malaysia	24.0
Singapore	17.0
US operations	2017: 35.0; 2018: 21.0
UK operations	2017 and 2018: 19.0; from 1 April 2020: 17.0

15 Insurance new business premiums[note (i)]

	Single premiums		Regular premiums		Annual premium equivalents (APE) note 13(i)(b)		Present value of new business premiums (PVNBP) note 13(i)(b)	
	2018 £m	**2017 £m**	**2018 £m**	**2017 £m**	**2018 £m**	**2017 £m**	**2018 £m**	**2017 £m**
Asia	**2,316**	2,299	**3,513**	3,575	**3,744**	3,805	**20,754**	20,405
US	**15,423**	16,622	**-**	-	**1,542**	1,662	**15,423**	16,622
UK and Europe	**13,382**	13,044	**177**	187	**1,516**	1,491	**14,073**	13,784
Group total	**31,121**	31,965	**3,690**	3,762	**6,802**	6,958	**50,250**	50,811
Asia								
Cambodia	**-**	-	**20**	16	**20**	16	**89**	70
Hong Kong	**343**	582	**1,663**	1,667	**1,697**	1,725	**10,200**	10,027
Indonesia	**205**	288	**215**	268	**236**	297	**910**	1,183
Malaysia	**84**	73	**243**	271	**251**	278	**1,322**	1,398
Philippines	**43**	62	**83**	71	**87**	77	**296**	287
Singapore	**930**	859	**369**	361	**462**	447	**3,611**	3,463
Thailand	**217**	139	**95**	70	**117**	84	**609**	421
Vietnam	**20**	8	**144**	133	**146**	134	**708**	659
South-east Asia operations including Hong Kong	**1,842**	2,011	**2,832**	2,857	**3,016**	3,058	**17,745**	17,508
China[note (ii)]	**103**	179	**292**	276	**302**	294	**1,313**	1,299
Taiwan	**292**	46	**182**	208	**211**	213	**788**	634
India[note (iii)]	**79**	63	**207**	234	**215**	240	**908**	964
Total	**2,316**	2,299	**3,513**	3,575	**3,744**	3,805	**20,754**	20,405
US								
Variable annuities	**10,810**	11,536	**-**	-	**1,081**	1,154	**10,810**	11,536
Elite Access (variable annuity)	**1,681**	2,013	**-**	-	**168**	201	**1,681**	2,013
Fixed annuities	**340**	454	**-**	-	**34**	45	**340**	454
Fixed index annuities	**251**	295	**-**	-	**25**	30	**251**	295
Wholesale	**2,341**	2,324	**-**	-	**234**	232	**2,341**	2,324
Total	**15,423**	16,622	**-**	-	**1,542**	1,662	**15,423**	16,622
UK and Europe								
Bonds	**3,539**	3,509	**-**	-	**354**	351	**3,540**	3,510
Corporate pensions	**69**	103	**117**	130	**124**	140	**443**	533
Individual pensions	**5,681**	5,747	**35**	32	**603**	607	**5,832**	5,897
Income drawdown	**2,555**	2,218	**-**	-	**256**	222	**2,555**	2,218
Other products	**1,538**	1,467	**25**	25	**179**	171	**1,703**	1,626
Total	**13,382**	13,044	**177**	187	**1,516**	1,491	**14,073**	13,784
Group total	**31,121**	31,965	**3,690**	3,762	**6,802**	6,958	**50,250**	50,811

Notes

(i) The tables shown above are provided as an indicative volume measure of transactions undertaken in the reporting period that have the potential to generate profits for shareholders. The amounts shown are not, and not intended to be, reflective of premium income recorded in the IFRS income statement.

(ii) New business in China is included at Prudential's 50 per cent interest in the China life operation.

(iii) New business in India is included at Prudential's 26 per cent interest in the India life operation.

16 Impact of US tax reform

On 22 December 2017, The Tax Cuts and Jobs Act in the US was enacted into law effective from 1 January 2018. The tax reform package as a whole, which included a reduction in the corporate income tax rate from 35 per cent to 21 per cent and a number of specific measures affecting US life insurers, resulted in a £390 million benefit in non-operating profit reflected within the 2017 results. The positive impact on an EEV basis represented the benefit of future profits being taxed at a lower rate, partially offset by a reduction in the net deferred tax asset held in the balance sheet to reflect remeasurement at the new lower tax rate, together with a reduction in the benefit from the dividend received deduction on taxable profits from variable annuity business. In June 2018, the National Association of Insurance Commissioners (NAIC) formally approved changes to RBC capital factors that reflected the December 2017 US tax reform and the 2018 EEV results reflect these changes as shown in notes 6 and 9.

17 Corporate transactions

Disposals and other corporate transactions

	2018 £m	2017 £m
Transactions associated with M&GPrudential[note (i)]	**(376)**	-
Other transactions[note (ii)]	**(75)**	80
	(451)	80

Notes

(i) Transactions associated with M&GPrudential

The following transactions reduced the Group's EEV by £(376) million, which primarily reflects the loss of profits on the portion of annuity liabilities sold.

Intention to demerge the Group's UK and Europe business and transfer of Hong Kong insurance subsidiaries

In March 2018, the Group announced its intention to demerge its UK and Europe business (M&GPrudential) from Prudential plc, resulting in two separately listed companies. In preparation for the UK demerger process, during December 2018, the legal ownership of Prudential plc's Hong Kong insurance subsidiaries was transferred from The Prudential Assurance Company Limited (M&GPrudential's UK regulated Insurance entity) to Prudential Corporation Asia Limited.

Sale of shareholder annuity portfolio

In March 2018, M&GPrudential reinsured £12.0 billion of its shareholder annuity portfolio (IFRS liabilities valued as at 31 December 2017) to Rothesay Life. Under the terms of the agreement, the reinsurance is expected to be followed by a Part VII transfer of most of the reinsured portfolio by 30 June 2019. The 2018 EEV results include the impact on EEV resulting from this transfer.

(ii) Other transactions

In 2018, other corporate transactions resulted in an EEV loss of £(75) million (2017: £80 million gain). This primarily relates to additional costs incurred in exiting the US broker-dealer business (which realised a post-tax gain of £80 million when the independent broker-dealer network was sold to LPL Financial LLC in 2017) and costs related to the preparation for the announced demerger discussed above.

18 Post balance sheet events

Renewal of strategic bancassurance alliance with United Overseas Bank Limited

In January 2019, the Group announced the renewal of its regional strategic bancassurance alliance with United Overseas Bank Limited (UOB). The new agreement extends the original alliance which commenced in 2010 to 2034 and increases the geographical scope to include a fifth market, Vietnam, alongside the existing markets across Singapore, Malaysia, Thailand and Indonesia.

As part of this transaction, Prudential has agreed to pay UOB an initial fee of £662 million (translated using a Singapore dollar: £ foreign exchange rate of 1.7360) for distribution rights which is not dependent on future sales volumes. This amount will be paid in three instalments of £230 million in February 2019, £331 million in January 2020 and £101 million in January 2021. In line with the Group's policy, these amounts will be capitalised as distribution rights intangible asset.

Additional EEV financial information*

A New business

BASIS OF PREPARATION

The format of the schedules is consistent with the distinction between insurance and investment products as applied for previous financial reporting periods. With the exception of some US institutional business, products categorised as 'insurance' refer to those classified as contracts of long-term insurance business for regulatory reporting purposes, ie falling within one of the classes of insurance specified in Part II of Schedule 1 to the Regulated Activities Order under Prudential Regulation Authority regulations.

The details shown for insurance products include contributions for contracts that are classified under IFRS 4 'Insurance Contracts' as not containing significant insurance risk. These products are described as investment contracts or other financial instruments under IFRS. Contracts included in this category are primarily certain unit-linked and similar contracts written in UK and Europe Insurance Operations, and Guaranteed Investment Contracts and similar funding agreements written in US Insurance Operations.

New business premiums reflect those premiums attaching to covered business, including premiums for contracts designed as investment products for IFRS reporting and for regular premium products are shown on an annualised basis.

Investment products referred to in the tables for funds under management are unit trusts, mutual funds and similar types of retail fund management arrangements. These are unrelated to insurance products that are classified as investment contracts under IFRS 4, as described in the preceding paragraph, although similar IFRS recognition and measurement principles apply to the acquisition costs and fees attaching to this type of business.

Post-tax New Business Profit has been determined using the European Embedded Value (EEV) methodology set out in our EEV basis results supplement.

In determining the EEV basis value of new business written in the period when policies incept, premiums are included in projected cash flows on the same basis of distinguishing annual and single premium business as set out for statutory basis reporting.

Annual premium equivalent (APE) sales are subject to rounding.

* The additional financial information is not covered by the KPMG LLP independent audit opinion.

Notes to Schedules A(i) to A(v)

(1) Prudential plc reports its results using both actual exchange rates (AER) and constant exchange rates (CER) so as to eliminate the impact of exchange translation.

	Average rate*			Closing rate		
Local currency : £	**2018**	**2017**	**% appreciation (depreciation) of local currency against GBP**	**31 Dec 2018**	**31 Dec 2017**	**% appreciation (depreciation) of local currency against GBP**
China	**8.82**	8.71	(1)%	**8.74**	8.81	1%
Hong Kong	**10.46**	10.04	(4)%	**9.97**	10.57	6%
Indonesia	**18,987.65**	17,249.38	(9)%	**18,314.37**	18,353.44	0%
Malaysia	**5.38**	5.54	3%	**5.26**	5.47	4%
Singapore	**1.80**	1.78	(1)%	**1.74**	1.81	4%
Thailand	**43.13**	43.71	1%	**41.47**	44.09	6%
US	**1.34**	1.29	(4)%	**1.27**	1.35	6%
Vietnam	**30,732.53**	29,279.71	(5)%	**29,541.15**	30,719.60	4%

* Average rate is for the 12 month period to 31 December.

(2) Annual premium equivalents (APE), calculated as the aggregate of regular premiums on business written in the period and one-tenth of single premiums, are subject to rounding. Present value of new business premiums (PVNBP) are calculated as the aggregate of single premiums and the present value of expected future premiums from regular premium new business, allowing for lapses and the other assumptions applied in determining the EEV new business profit.
(3) Balance includes segregated and pooled pension funds, private finance assets and other institutional clients.
(4) New business in India is included at Prudential's 26 per cent interest in the India life operation.
(5) Balance sheet figures have been calculated at the closing exchange rates.
(6) New business in China is included at Prudential's 50 per cent interest in the China life operation.
(7) Mandatory Provident Fund (MPF) product sales in Hong Kong are included at Prudential's 36 per cent interest in Hong Kong MPF operation.
(8) Investment flows for the year exclude year-to-date Eastspring Money Market Funds (MMF) gross inflow of £191,523 million (2017: gross inflow of £192,662 million) and net inflow of £1,500 million (2017: net inflow of £1,495 million).
(9) Total Group Investment Operations funds under management exclude MMF funds under management of £11,602 million at 31 December 2018 (31 December 2017: £9,317 million).

Schedule A(i) New Business Insurance Operations (Actual Exchange Rates)

Note: The 2017 comparative results are shown below on actual exchange rates (AER) as previously reported.

	Single premiums			Regular premiums			APE note(2)			PVNBP note(2)		
	2018	2017	+/(-)	2018	2017	+/(-)	2018	2017	+/(-)	2018	2017	+/(-)
	£m	£m	%	£m	£m	%	£m	£m	%	£m	£m	%
Asia	**2,316**	2,299	1%	**3,513**	3,575	(2)%	**3,744**	3,805	(2)%	**20,754**	20,405	2%
US	**15,423**	16,622	(7)%	**-**	-	-	**1,542**	1,662	(7)%	**15,423**	16,622	(7)%
UK and Europe	**13,382**	13,044	3%	**177**	187	(5)%	**1,516**	1,491	2%	**14,073**	13,784	2%
Group total	**31,121**	31,965	(3)%	**3,690**	3,762	(2)%	**6,802**	6,958	(2)%	**50,250**	50,811	(1)%
Asia												
Cambodia	**-**	-	-	**20**	16	25%	**20**	16	25%	**89**	70	27%
Hong Kong	**343**	582	(41)%	**1,663**	1,667	(0)%	**1,697**	1,725	(2)%	**10,200**	10,027	2%
Indonesia	**205**	288	(29)%	**215**	268	(20)%	**236**	297	(21)%	**910**	1,183	(23)%
Malaysia	**84**	73	15%	**243**	271	(10)%	**251**	278	(10)%	**1,322**	1,398	(5)%
Philippines	**43**	62	(31)%	**83**	71	17%	**87**	77	13%	**296**	287	3%
Singapore	**930**	859	8%	**369**	361	2%	**462**	447	3%	**3,611**	3,463	4%
Thailand	**217**	139	56%	**95**	70	36%	**117**	84	39%	**609**	421	45%
Vietnam	**20**	8	150%	**144**	133	8%	**146**	134	9%	**708**	659	7%
South-east Asia operations including Hong Kong	**1,842**	2,011	(8)%	**2,832**	2,857	(1)%	**3,016**	3,058	(1)%	**17,745**	17,508	1%
China note (6)	**103**	179	(42)%	**292**	276	6%	**302**	294	3%	**1,313**	1,299	1%
Taiwan	**292**	46	535%	**182**	208	(13)%	**211**	213	(1)%	**788**	634	24%
India note (4)	**79**	63	25%	**207**	234	(12)%	**215**	240	(10)%	**908**	964	(6)%
Total Asia	**2,316**	2,299	1%	**3,513**	3,575	(2)%	**3,744**	3,805	(2)%	**20,754**	20,405	2%
US												
Variable annuities	**10,810**	11,536	(6)%	**-**	-	-	**1,081**	1,154	(6)%	**10,810**	11,536	(6)%
Elite Access (variable annuity)	**1,681**	2,013	(16)%	**-**	-	-	**168**	201	(16)%	**1,681**	2,013	(16)%
Fixed annuities	**340**	454	(25)%	**-**	-	-	**34**	45	(24)%	**340**	454	(25)%
Fixed index annuities	**251**	295	(15)%	**-**	-	-	**25**	30	(17)%	**251**	295	(15)%
Wholesale	**2,341**	2,324	1%	**-**	-	-	**234**	232	1%	**2,341**	2,324	1%
Total US	**15,423**	16,622	(7)%	**-**	-	-	**1,542**	1,662	(7)%	**15,423**	16,622	(7)%
UK and Europe												
Bonds	**3,539**	3,509	1%	**-**	-	-	**354**	351	1%	**3,540**	3,510	1%
Corporate pensions	**69**	103	(33)%	**117**	130	(10)%	**124**	140	(11)%	**443**	533	(17)%
Individual pensions	**5,681**	5,747	(1)%	**35**	32	9%	**603**	607	(1)%	**5,832**	5,897	(1)%
Income drawdown	**2,555**	2,218	15%	**-**	-	-	**256**	222	15%	**2,555**	2,218	15%
Other products	**1,538**	1,467	5%	**25**	25	-	**179**	171	5%	**1,703**	1,626	5%
Total UK and Europe	**13,382**	13,044	3%	**177**	187	(5)%	**1,516**	1,491	2%	**14,073**	13,784	2%
Group total	**31,121**	31,965	(3)%	**3,690**	3,762	(2)%	**6,802**	6,958	(2)%	**50,250**	50,811	(1)%

During 2018, the Africa business operations sold £38 million APE of new business. Given the relative immaturity of the Africa business, it is incorporated into the Group's EEV results on an IFRS basis and hence excluded from our new business metrics.

Schedule A(ii) New Business Insurance Operations (Constant Exchange Rates)

Note: The 2017 comparative results are shown below on constant exchange rates (CER), ie translated at 2018 average exchange rates.

	Single premiums			Regular premiums			APE note (2)			PVNBP note (2)		
	2018	2017	+/(-)	2018	2017	+/(-)	2018	2017	+/(-)	2018	2017	+/(-)
	£m	£m	%	£m	£m	%	£m	£m	%	£m	£m	%
Asia	**2,316**	2,230	4%	**3,513**	3,450	2%	**3,744**	3,671	2%	**20,754**	19,730	5%
US	**15,423**	16,045	(4)%	**-**	-	-	**1,542**	1,605	(4)%	**15,423**	16,045	(4)%
UK and Europe	**13,382**	13,044	3%	**177**	187	(5)%	**1,516**	1,491	2%	**14,073**	13,784	2%
Group total	**31,121**	31,319	(1)%	**3,690**	3,637	1%	**6,802**	6,767	1%	**50,250**	49,559	1%
Asia												
Cambodia	**-**	-	-	**20**	16	25%	**20**	16	25%	**89**	67	33%
Hong Kong	**343**	558	(39)%	**1,663**	1,600	4%	**1,697**	1,655	3%	**10,200**	9,625	6%
Indonesia	**205**	262	(22)%	**215**	244	(12)%	**236**	270	(13)%	**910**	1,074	(15)%
Malaysia	**84**	75	12%	**243**	279	(13)%	**251**	286	(12)%	**1,322**	1,438	(8)%
Philippines	**43**	57	(25)%	**83**	65	28%	**87**	71	23%	**296**	266	11%
Singapore	**930**	849	10%	**369**	357	3%	**462**	442	5%	**3,611**	3,421	6%
Thailand	**217**	141	54%	**95**	71	34%	**117**	85	38%	**609**	426	43%
Vietnam	**20**	8	150%	**144**	127	13%	**146**	127	15%	**708**	628	13%
South-east Asia operations including Hong Kong	**1,842**	1,950	(6)%	**2,832**	2,759	3%	**3,016**	2,952	2%	**17,745**	16,945	5%
China note (6)	**103**	177	(42)%	**292**	273	7%	**302**	290	4%	**1,313**	1,282	2%
Taiwan	**292**	45	549%	**182**	203	(10)%	**211**	208	1%	**788**	617	28%
India note (4)	**79**	58	36%	**207**	215	(4)%	**215**	221	(3)%	**908**	886	2%
Total Asia	**2,316**	2,230	4%	**3,513**	3,450	2%	**3,744**	3,671	2%	**20,754**	19,730	5%
US												
Variable annuities	**10,810**	11,136	(3)%	**-**	**-**	-	**1,081**	1,114	(3)%	**10,810**	11,136	(3)%
Elite Access (variable annuity)	**1,681**	1,943	(13)%	**-**	-	-	**168**	194	(13)%	**1,681**	1,943	(13)%
Fixed annuities	**340**	438	(22)%	**-**	-	-	**34**	44	(23)%	**340**	438	(22)%
Fixed index annuities	**251**	285	(12)%	**-**	-	-	**25**	29	(14)%	**251**	285	(12)%
Wholesale	**2,341**	2,243	4%	**-**	-	-	**234**	224	4%	**2,341**	2,243	4%
Total US	**15,423**	16,045	(4)%	**-**	-	-	**1,542**	1,605	(4)%	**15,423**	16,045	(4)%
UK and Europe												
Bonds	**3,539**	3,509	1%	**-**	-	-	**354**	351	1%	**3,540**	3,510	1%
Corporate pensions	**69**	103	(33)%	**117**	130	(10)%	**124**	140	(11)%	**443**	533	(17)%
Individual pensions	**5,681**	5,747	(1)%	**35**	32	9%	**603**	607	(1)%	**5,832**	5,897	(1)%
Income drawdown	**2,555**	2,218	15%	**-**	-	-	**256**	222	15%	**2,555**	2,218	15%
Other products	**1,538**	1,467	5%	**25**	25	-	**179**	171	5%	**1,703**	1,626	5%
Total UK and Europe	**13,382**	13,044	3%	**177**	187	(5)%	**1,516**	1,491	2%	**14,073**	13,784	2%
Group total	**31,121**	31,319	(1)%	**3,690**	3,637	1%	**6,802**	6,767	1%	**50,250**	49,559	1%

Schedule A(iii) Total Insurance New Business APE (Actual and Constant Exchange Rates)

Note: Comparative results for the first half (H1) and second half (H2) of 2017 are presented on both actual exchange rates (AER) and constant exchange rates (CER). The H2 amounts are presented on year-to-date average exchange rates (including the effect of retranslating H1 results for movements in average exchange rates between H1 and the year-to-date).

	AER				CER			
	2017		2018		2017		2018	
	H1	H2	H1	H2	H1	H2	H1	H2
	£m	£m	£m	£m	£m	£m	£m	£m
Asia	1,943	1,862	1,736	2,008	1,840	1,831	1,765	1,979
US	960	702	816	726	906	699	841	701
UK and Europe	721	770	770	746	721	770	770	746
Group total	**3,624**	**3,334**	**3,322**	**3,480**	**3,467**	**3,300**	**3,376**	**3,426**
Asia								
Cambodia	8	8	8	12	8	8	9	11
Hong Kong	914	811	742	955	855	800	764	933
Indonesia	144	153	113	123	127	143	113	123
Malaysia	128	150	117	134	131	155	118	133
Philippines	36	41	38	49	32	39	39	48
Singapore	195	252	205	257	192	250	208	254
Thailand	42	42	53	64	43	42	54	63
Vietnam	62	72	61	85	58	69	62	84
South-east Asia operations including Hong Kong	**1,529**	**1,529**	**1,337**	**1,679**	**1,446**	**1,506**	**1,367**	**1,649**
China[note (6)]	187	107	187	115	183	107	186	116
Taiwan	105	108	108	103	101	107	109	102
India[note (4)]	122	118	104	111	110	111	103	112
Total Asia insurance operations	**1,943**	**1,862**	**1,736**	**2,008**	**1,840**	**1,831**	**1,765**	**1,979**
US								
Variable annuities	604	550	544	537	570	544	560	521
Elite Access (variable annuity)	110	91	89	79	104	90	93	75
Fixed annuities	24	21	17	17	23	21	17	17
Fixed index annuities	16	14	13	12	15	14	13	12
Wholesale	206	26	153	81	194	30	158	76
Total US	**960**	**702**	**816**	**726**	**906**	**699**	**841**	**701**
UK and Europe								
Bonds	174	177	165	189	174	177	165	189
Corporate pensions	75	65	75	49	75	65	75	49
Individual pensions	279	328	316	287	279	328	316	287
Income drawdown	106	116	123	133	106	116	123	133
Other products	87	84	91	88	87	84	91	88
Total UK and Europe	**721**	**770**	**770**	**746**	**721**	**770**	**770**	**746**
Group total	**3,624**	**3,334**	**3,322**	**3,480**	**3,467**	**3,300**	**3,376**	**3,426**

Schedule A(iv) Investment Operations (Actual Exchange Rates)

Note: The H1 and H2 of 2017 comparative results are shown below on actual exchange rates (AER) as previously reported.

	2017		2018	
	H1 £m	**H2 £m**	**H1 £m**	**H2 £m**
Opening FUM	174,805	193,714	210,423	207,860
Net Flows:note (8)	9,452	11,026	2,685	(14,186)
- Gross Inflows	34,213	35,201	31,857	26,227
- Redemptions	(24,761)	(24,175)	(29,172)	(40,413)
Other Movements	9,457	5,683	(5,248)	2,727
Group totalnote (9)	**193,714**	**210,423**	**207,860**	**196,401**
M&GPrudential				
Retail:				
Opening FUM	64,209	72,500	79,697	79,821
Net Flows:	5,515	5,528	2,154	(7,022)
- Gross Inflows	15,871	15,078	16,471	8,113
- Redemptions	(10,356)	(9,550)	(14,317)	(15,135)
Other Movements	2,776	1,669	(2,030)	(3,334)
Closing FUM	**72,500**	**79,697**	**79,821**	**69,465**
Comprising amounts for:				
UK	35,201	35,740	33,786	30,600
Europe (excluding UK)	35,192	42,321	44,571	37,523
South Africa	2,107	1,636	1,464	1,342
	72,500	**79,697**	**79,821**	**69,465**
Institutional:note (3)				
Opening FUM	72,554	76,618	84,158	85,669
Net Flows:	1,664	4,630	1,394	(6,441)
- Gross Inflows	6,806	8,414	4,930	8,024
- Redemptions	(5,142)	(3,784)	(3,536)	(14,465)
Other Movements	2,400	2,910	117	(1,747)
Closing FUM	**76,618**	**84,158**	**85,669**	**77,481**
Total M&GPrudential	**149,118**	**163,855**	**165,490**	**146,946**
PPM South Africa FUM included in total M&GPrudential	**5,427**	**5,963**	**5,452**	**5,144**
Eastspring - excluding MMFnote (8)				
Third party retail:note (7)				
Opening FUM	30,793	36,093	38,676	36,086
Net Flows:	2,186	1,567	25	(692)
- Gross Inflows	10,781	11,017	10,118	9,125
- Redemptions	(8,595)	(9,450)	(10,093)	(9,817)
Other Movements*	3,114	1,016	(2,615)	7,946
Closing FUMnote (5)	**36,093**	**38,676**	**36,086**	**43,340**
Third party institutional:				
Opening FUM	7,249	8,503	7,892	6,284
Net Flows:	87	(699)	(888)	(31)
- Gross Inflows	755	692	338	965
- Redemptions	(668)	(1,391)	(1,226)	(996)
Other Movements	1,167	88	(720)	(138)
Closing FUMnote (5)	**8,503**	**7,892**	**6,284**	**6,115**
Total Eastspring investment operations (excluding MMF)	**44,596**	**46,568**	**42,370**	**49,455**

* Other movements during the year for Eastspring investments include an inflow of £8.7 billion funds under management (ex MMF) from the acquisition of TMB Asset Management Co., Ltd. ('TMBAM') in Thailand. See note D1.2 of the consolidated financial statements for further details.

Schedule A(v) Total Insurance New Business Profit (Actual and Constant Exchange Rates)

Note: Comparative results for half year (HY) and full year (FY) 2017 are presented on both actual exchange rates (AER) and constant exchange rates (CER). The full year 2018 results are presented on actual exchange rates.

	AER				CER			
	2017		2018		2017		2018	
	HY £m	FY £m	HY £m	FY £m	HY £m	FY £m	HY £m	FY £m
New business profit (NBP)								
Total Asia insurance operations	1,092	2,368	1,122	2,604	1,030	2,282	1,147	2,604
Total US insurance operations	436	906	466	921	412	874	480	921
Total UK and Europe insurance operations	161	342	179	352	161	342	179	352
Group total	**1,689**	**3,616**	**1,767**	**3,877**	**1,603**	**3,498**	**1,806**	**3,877**
APE note (2)								
Total Asia insurance operations	1,943	3,805	1,736	3,744	1,840	3,671	1,765	3,744
Total US insurance operations	960	1,662	816	1,542	906	1,605	841	1,542
Total UK and Europe insurance operations	721	1,491	770	1,516	721	1,491	770	1,516
Group total	**3,624**	**6,958**	**3,322**	**6,802**	**3,467**	**6,767**	**3,376**	**6,802**
New business margin (NBP as % of APE)								
Total Asia insurance operations	56%	62%	65%	70%	56%	62%	65%	70%
Total US insurance operations	45%	55%	57%	60%	45%	55%	57%	60%
Total UK and Europe insurance operations	22%	23%	23%	23%	22%	23%	23%	23%
Group total	**47%**	**52%**	**53%**	**57%**	**46%**	**52%**	**53%**	**57%**
PVNBP note (2)								
Total Asia insurance operations	10,095	20,405	9,132	20,754	9,584	19,730	9,292	20,754
Total US insurance operations	9,602	16,622	8,163	15,423	9,062	16,045	8,412	15,423
Total UK and Europe insurance operations	6,616	13,784	7,088	14,073	6,616	13,784	7,088	14,073
Group total	**26,313**	**50,811**	**24,383**	**50,250**	**25,262**	**49,559**	**24,792**	**50,250**
New business margin (NBP as % of PVNBP)								
Total Asia insurance operations	10.8%	11.6%	12.3%	12.5%	10.7%	11.6%	12.3%	12.5%
Total US insurance operations	4.5%	5.5%	5.7%	6.0%	4.5%	5.5%	5.7%	6.0%
Total UK and Europe insurance operations	2.4%	2.5%	2.5%	2.5%	2.4%	2.5%	2.5%	2.5%
Group total	**6.4%**	**7.1%**	**7.2%**	**7.7%**	**6.3%**	**7.1%**	**7.3%**	**7.7%**

B Reconciliation of expected transfer of value of in-force business and required capital to free surplus

The tables below show how the value of in-force business (VIF) generated by the in-force long-term business and the associated required capital is modelled as emerging into free surplus over the next 40 years. Although a small amount (circa 5 per cent) of the Group's embedded value emerges after this date, analysis of cash flows emerging in the years shown in the tables is considered most meaningful. The modelled cash flows use the same methodology underpinning the Group's embedded value reporting and so are subject to the same assumptions and sensitivities used to prepare our 2018 results.

In addition to showing the amounts, both discounted and undiscounted, expected to be generated from all in-force business at 31 December 2018, the tables also present the expected future free surplus to be generated from the investment made in new business during 2018 over the same 40-year period for long-term business operations.

	31 Dec 2018 £m							
	Undiscounted expected generation from all in-force business*				Undiscounted expected generation from new business written*			
Expected period of emergence	Asia	US	UK and Europe	Total	Asia	US	UK and Europe	Total
2019	1,560	1,584	593	**3,737**	204	205	31	**440**
2020	1,504	1,674	609	**3,787**	200	153	34	**387**
2021	1,446	1,737	591	**3,774**	195	147	36	**378**
2022	1,441	1,674	572	**3,687**	206	154	38	**398**
2023	1,438	1,625	555	**3,618**	187	122	42	**351**
2024	1,371	1,629	537	**3,537**	166	73	38	**277**
2025	1,345	1,407	521	**3,273**	176	60	36	**272**
2026	1,332	1,249	497	**3,078**	167	166	35	**368**
2027	1,309	1,224	472	**3,005**	155	163	34	**352**
2028	1,266	1,143	448	**2,857**	163	147	34	**344**
2029	1,177	1,056	425	**2,658**	131	136	32	**299**
2030	1,169	962	402	**2,533**	134	129	31	**294**
2031	1,145	798	379	**2,322**	122	108	29	**259**
2032	1,131	645	465	**2,241**	120	97	30	**247**
2033	1,115	422	435	**1,972**	137	85	29	**251**
2034	1,061	448	405	**1,914**	119	74	27	**220**
2035	1,059	242	375	**1,676**	120	51	25	**196**
2036	1,081	135	346	**1,562**	120	49	24	**193**
2037	1,113	94	319	**1,526**	120	44	23	**187**
2038	1,104	102	292	**1,498**	129	44	22	**195**
2039-2043	6,131	320	1,137	**7,588**	884	84	83	**1,051**
2044-2048	5,843	-	696	**6,539**	944	-	49	**993**
2049-2053	5,452	-	329	**5,781**	922	-	31	**953**
2054-2058	4,964	-	157	**5,121**	897	-	17	**914**
Total free surplus expected to emerge in the next 40 years	47,557	20,170	11,557	**79,284**	6,718	2,291	810	**9,819**

* The analysis excludes amounts incorporated into VIF at 31 December 2018 where there is no definitive time frame for when the payments will be made or receipts received. In particular, it excludes the value of the shareholders' interest in the with-profits estate. It also excludes any free surplus emerging after 2058.

The above amounts can be reconciled to the new business amounts as follows:

	2018 £m			
	Asia	US	UK and Europe	Total
Undiscounted expected free surplus generation for years 2019 to 2058	6,718	2,291	810	**9,819**
Less: discount effect	(3,964)	(905)	(352)	**(5,221)**
Discounted expected free surplus generation for years 2019 to 2058	2,754	1,386	458	**4,598**
Discounted expected free surplus generation for years after 2058	863	-	1	**864**
Less: Free surplus investment in new business	(488)	(225)	(102)	**(815)**
Other items†	(525)	(240)	(5)	**(770)**
Post-tax EEV new business profit for long-term business operations	2,604	921	352	**3,877**

† Other items represent the impact of the time value of options and guarantees on new business, foreign exchange effects and other non-modelled items. Foreign exchange effects arise as EEV new business profit amounts are translated at average exchange rates and the expected free surplus generation uses year end closing rates.

The undiscounted expected free surplus generation from all in-force business at 31 December 2018 shown below can be reconciled to the amount that was expected to be generated as at 31 December 2017 as follows:

Group	2018 £m	2019 £m	2020 £m	2021 £m	2022 £m	2023 £m	Other £m	Total £m
2017 expected free surplus generation for years 2018 to 2057	3,528	3,462	3,456	3,467	3,318	3,253	49,636	**70,120**
Less: Amounts expected to be realised in the current year	(3,528)	-	-	-	-	-	-	**(3,528)**
Add: Expected free surplus to be generated in year 2058*	-	-	-	-	-	-	649	**649**
Foreign exchange differences	-	129	132	137	132	132	1,916	**2,578**
New business	-	440	387	378	398	351	7,865	**9,819**
Operating movements	-	(52)	(60)	(22)	23	56		
Non-operating and other movements	-	(242)	(128)	(186)	(184)	(174)	615	**(354)**
2018 expected free surplus generation for years 2019 to 2058	-	3,737	3,787	3,774	3,687	3,618	60,681	**79,284**

Asia operations	2018 £m	2019 £m	2020 £m	2021 £m	2022 £m	2023 £m	Other £m	Total £m
2017 expected free surplus generation for years 2018 to 2057	1,393	1,352	1,299	1,256	1,239	1,202	30,029	**37,770**
Less: Amounts expected to be realised in the current year	(1,393)	-	-	-	-	-	-	**(1,393)**
Add: Expected free surplus to be generated in year 2058*	-	-	-	-	-	-	610	**610**
Foreign exchange differences	-	40	40	41	42	43	1,304	**1,510**
New business	-	204	200	195	206	187	5,726	**6,718**
Operating movements	-	(24)	(38)	(42)	(25)	(22)		
Non-operating and other movements	-	(12)	3	(4)	(21)	28	2,499	**2,342**
2018 expected free surplus generation for years 2019 to 2058	-	1,560	1,504	1,446	1,441	1,438	40,168	**47,557**

US operations	2018 £m	2019 £m	2020 £m	2021 £m	2022 £m	2023 £m	Other £m	Total £m
2017 expected free surplus generation for years 2018 to 2057	1,464	1,425	1,483	1,551	1,441	1,433	9,847	**18,644**
Less: Amounts expected to be realised in the current year	(1,464)	-	-	-	-	-	-	**(1,464)**
Foreign exchange differences	-	89	92	96	90	89	612	**1,068**
New business	-	205	153	147	154	122	1,510	**2,291**
Operating movements	-	(25)	(18)	27	58	85		
Non-operating and other movements	-	(110)	(36)	(84)	(69)	(104)	(93)	**(369)**
2018 expected free surplus generation for years 2019 to 2058	-	1,584	1,674	1,737	1,674	1,625	11,876	**20,170**

M&GPrudential insurance operations	2018 £m	2019 £m	2020 £m	2021 £m	2022 £m	2023 £m	Other £m	Total £m
2017 expected free surplus generation for years 2018 to 2056	671	685	674	660	638	618	9,760	**13,706**
Less: Amounts expected to be realised in the current year	(671)	-	-	-	-	-	-	**(671)**
Add: Expected free surplus to be generated in year 2058*	-	-	-	-	-	-	39	**39**
New business	-	31	34	36	38	42	629	**810**
Operating movements	-	(3)	(4)	(7)	(10)	(7)		
Non-operating and other movements	-	(120)	(95)	(98)	(94)	(98)	(1,791)	**(2,327)**
2018 expected free surplus generation for years 2019 to 2058	-	593	609	591	572	555	8,637	**11,557**

* Excluding 2018 new business.

At 31 December 2018, the total free surplus expected to be generated over the next five years (2019 to 2023 inclusive), using the same assumptions and methodology as those underpinning our 2018 embedded value reporting was £18.6 billion, an increase of £1.4 billion from the £17.2 billion expected over an equivalent period from the end of 2017.

This increase primarily reflects the new business written in 2018, which is expected to generate £1,954 million of free surplus over the next five years.

At 31 December 2018, the total free surplus expected to be generated on an undiscounted basis in the next 40 years is £79.3 billion, up from the £70.1 billion expected at the end of 2017, reflecting the effect of new business written across all three business operations of £9.8 billion, a positive foreign exchange translation effect of £2.6 billion and a £(0.4) billion net effect reflecting operating, market assumption changes and other items. The £2.3 billion impact in Asia of operating, non-operating and other movements includes the net benefit from changes in operating assumptions following the annual review of experience, together with the benefit of management actions and generally higher interest rates increasing projected returns. The £(0.4) billion impact in the US mainly reflects the effect of lower than expected separate account return in the year, partially offset by the positive effect from persistency assumption updates and higher interest rates increasing future separate account return. The £(2.3) billion impact in the UK and Europe reflects the effect of lower than assumed investment returns on with-profits funds and the reinsurance of part of its shareholder annuity portfolio to Rothesay Life as discussed in note 17. The overall growth in the Group's undiscounted value of free surplus reflects our ability to write both growing and profitable new business.

Actual underlying free surplus generated in 2018 from life business in force, before restructuring costs, at the end of 2018 was £4.4 billion including £0.8 billion of changes in operating assumptions and experience variances. This compares with the expected 2018 realisation at the end of 2017 of £3.5 billion. In the UK and Europe, the difference between the transfer to free surplus recognised in 2018 and the free surplus expected to be generated at 31 December 2017 reflects the reinsurance of the shareholder annuity portfolio to Rothesay Life (as discussed in note 17) which was not known at 2017. This can be analysed further as follows:

	Asia £m	US £m	UK and Europe £m	Total £m
Transfer to free surplus in 2018	**1,370**	**1,462**	**607**	**3,439**
Expected return on free assets	**68**	**54**	**79**	**201**
Changes in operating assumptions and experience variances	**62**	**125**	**591**	**778**
Underlying free surplus generated from in-force life business before restructuring costs in 2018	**1,500**	**1,641**	**1,277**	**4,418**
2018 free surplus expected to be generated at 31 December 2017	1,393	1,464	671	3,528

The equivalent discounted amounts of the undiscounted expected transfers from in-force business and required capital into free surplus shown previously are as follows:

	31 Dec 2018 £m							
	Discounted expected generation from all in-force business				**Discounted expected generation from new business written**			
Expected period of emergence	**Asia**	**US**	**UK and Europe**	**Total**	**Asia**	**US**	**UK and Europe**	**Total**
2019	1,495	1,497	579	**3,571**	194	198	31	**423**
2020	1,353	1,486	568	**3,407**	176	139	32	**347**
2021	1,217	1,447	531	**3,195**	161	126	33	**320**
2022	1,140	1,307	488	**2,935**	159	121	34	**314**
2023	1,071	1,191	450	**2,712**	138	92	35	**265**
2024	965	1,120	411	**2,496**	116	52	31	**199**
2025	895	910	379	**2,184**	118	41	28	**187**
2026	835	760	341	**1,936**	106	100	26	**232**
2027	776	694	308	**1,778**	92	92	24	**208**
2028	714	610	274	**1,598**	92	77	22	**191**
2029	624	527	245	**1,396**	68	67	20	**155**
2030	588	452	215	**1,255**	65	60	18	**143**
2031	548	355	187	**1,090**	56	46	16	**118**
2032	516	273	218	**1,007**	52	39	16	**107**
2033	486	164	188	**838**	56	32	14	**102**
2034	436	165	163	**764**	47	25	12	**84**
2035	415	93	139	**647**	45	16	10	**71**
2036	409	52	123	**584**	43	14	9	**66**
2037	407	33	110	**550**	41	12	8	**61**
2038	386	35	98	**519**	43	11	6	**60**
2039-2043	1,951	123	324	**2,398**	285	26	21	**332**
2044-2048	1,509	-	110	**1,619**	251	-	10	**261**
2049-2053	1,128	-	38	**1,166**	197	-	2	**199**
2054-2058	811	-	4	**815**	153	-	-	**153**
Total discounted free surplus expected to emerge in the next 40 years	20,675	13,294	6,491	**40,460**	2,754	1,386	458	**4,598**

The above amounts can be reconciled to the Group's EEV basis financial statements as follows:

	31 Dec 2018 £m
Discounted expected generation from all in-force business for years 2019 to 2058	**40,460**
Discounted expected generation from all in-force business for years after 2058	**2,659**
Discounted expected generation from all in-force business at 31 December 2018	**43,119**
Add: Free surplus of life operations held at 31 December 2018	**7,527**
Less: Time value of guarantees	**(2,427)**
Other non-modelled items	**2,169**
Total EEV for long-term business operations	**50,388**

C Foreign currency source of key metrics

The tables below show the Group's free surplus, IFRS and EEV key metrics analysis by contribution by currency group:

Free surplus and Group IFRS results

	Underlying free surplus generated for total insurance and asset management operations note (iii)	IFRS pre-tax operating profit notes (ii),(iv)	IFRS shareholders' funds notes (ii),(iv)
US dollar linked[note (i)]	**15%**	**28%**	**22%**
Other Asia currencies	**13%**	**17%**	**15%**
Total Asia	**28%**	**45%**	**37%**
UK sterling[notes (ii),(iv)]	**39%**	**15%**	**49%**
US dollar[note (iv)]	**33%**	**40%**	**14%**
Total	**100%**	**100%**	**100%**

Group EEV post-tax results

	New business profit	Operating profit notes (ii),(iv)	Shareholders' funds notes (i),(iv)
US dollar linked[note (i)]	**57%**	**53%**	**40%**
Other Asia currencies	**10%**	**7%**	**10%**
Total Asia	**67%**	**60%**	**50%**
UK sterling[notes (ii),(iv)]	**9%**	**12%**	**26%**
US dollar[note (iv)]	**24%**	**28%**	**24%**
Total	**100%**	**100%**	**100%**

Notes

(i) US dollar linked comprise the Hong Kong and Vietnam operations where the currencies are pegged to the US dollar and the Malaysia and Singapore operations where the currencies are managed against a basket of currencies including the US dollar.

(ii) For operating profit and shareholders' funds, UK sterling includes amounts in respect of M&GPrudential and other operations (including central operations and Prudential Capital). Operating profit for central operations includes amounts for corporate expenditure for Group Head Office as well as Asia Regional Head Office which is incurred in HK dollars as well as restructuring costs incurred by the Group.

(iii) For operating free surplus generation, UK sterling includes amounts in respect of restructuring costs incurred by insurance and asset management operations.

(iv) For shareholders' funds, the US dollar grouping includes US dollar denominated core structural borrowings. Sterling operating profits include all interest payable as sterling denominated, reflecting interest rate currency swaps in place.

Risk Factors

A number of risk factors affect Prudential's operating results and financial condition and, accordingly, the trading price of its shares. The risk factors mentioned below should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties. The information given is as of the date of this document, and any forward-looking statements are made subject to the reservations specified under 'Forward-looking statements'.

Prudential's approaches to managing risks are explained in the section of this document headed 'Group Chief Risk Officer's Report on the risks facing our business and how these are managed'.

Risks relating to Prudential's business

Prudential's businesses are inherently subject to market fluctuations and general economic conditions
Uncertainty, fluctuations or negative trends in international economic and investment climates could have a material adverse effect on Prudential's business and profitability. Prudential operates in a macroeconomic and global financial market environment that presents significant uncertainties and potential challenges. For example, government interest rates in the US, the UK and some Asian countries in which Prudential operates remain low relative to historical levels.

Global financial markets are subject to uncertainty and volatility created by a variety of factors. These factors include the continuing reduction in accommodative monetary policies in the US, the UK and other jurisdictions together with its impact on the valuation of all asset classes, effects on interest rates and the risk of disorderly repricing of inflation expectations and global bond yields, concerns over sovereign debt, a general slowing in world growth, the increased level of geopolitical risk and policy-related uncertainty (including the imposition of trade barriers) and potentially negative socio-political events.

The adverse effects of such factors could be felt principally through the following items:

- Reduced investment returns arising on the Group's portfolios including impairment of debt securities and loans, which could reduce Prudential's capital and impair its ability to write significant volumes of new business, increase the potential adverse impact of product guarantees, and/or have a negative impact on its assets under management and profit;
- Higher credit defaults and wider credit and liquidity spreads resulting in realised and unrealised credit losses;
- Failure of counterparties who have transactions with Prudential (eg banks and reinsurers) to meet commitments that could give rise to a negative impact on Prudential's financial position and on the accessibility or recoverability of amounts due or, for derivative transactions, adequate collateral not being in place;
- Estimates of the value of financial instruments becoming more difficult because in certain illiquid or closed markets, determining the value at which financial instruments can be realised is highly subjective. Processes to ascertain such values require substantial elements of judgement, assumptions and estimates (which may change over time); and
- Increased illiquidity, which also adds to uncertainty over the accessibility of financial resources and may reduce capital resources as valuations decline. This could occur where external capital is unavailable at sustainable cost, increased liquid assets are required to be held as collateral under derivative transactions or redemption restrictions are placed on Prudential's investments in illiquid funds. In addition, significant redemption requests could also be made on Prudential's issued funds and while this may not have a direct impact on the Group's liquidity, it could result in reputational damage to Prudential. The potential impact of increased illiquidity is more uncertain than for other risks such as interest rate or credit risk.

In general, upheavals in the financial markets may affect general levels of economic activity, employment and customer behaviour. As a result, insurers may experience an elevated incidence of claims, lapses, or surrenders of policies, and some policyholders may choose to defer or stop paying insurance premiums. The demand for insurance products may also be adversely affected. In addition, there may be a higher incidence of counterparty failures. If sustained, this environment is likely to have a negative impact on the insurance sector over time and may consequently have a negative impact on Prudential's business and its balance sheet and profitability. For example, this could occur if the recoverable value of intangible assets for bancassurance agreements and deferred acquisition costs are reduced. New challenges related to market fluctuations and general economic conditions may continue to emerge.

For some non-unit-linked investment products, in particular those written in some of the Group's Asia operations, it may not be possible to hold assets which will provide cash flows to match those relating to policyholder liabilities. This is particularly true in those countries where bond markets are not developed and in certain markets where regulated premium and claim values are set with reference to the interest rate environment prevailing at the time of policy issue. This results in a mismatch due to the duration and uncertainty of the liability cash flows and the lack of sufficient assets of a suitable duration. While this residual asset/liability mismatch risk can be managed, it cannot be eliminated. Where interest rates in these markets remain lower than those used to calculate premium and claim values over a sustained period, this could have a material adverse effect on Prudential's reported profit.

Jackson writes a significant amount of variable annuities that offer capital or income protection guarantees. The value of these guarantees is affected by market factors (such as interest rates, equity values, bond spreads and realised volatility) and policyholder behaviour. Jackson uses a derivative hedging programme to reduce its exposure to market risks arising on these guarantees. There could be market circumstances where the derivatives that Jackson enters into to hedge its market risks may not cover its exposures under the guarantees. The cost of the guarantees that remain unhedged will also affect Prudential's results.

In addition, Jackson hedges the guarantees on its variable annuity book on an economic basis (with consideration of the local regulatory position) and, thus, accepts variability in its accounting results in the short term in order to achieve the appropriate result on these bases. In particular, for Prudential's Group IFRS reporting, the measurement of the Jackson variable annuity guarantees is typically less sensitive to market movements than for the corresponding hedging derivatives, which are held at market value. However, depending on the level of hedging conducted regarding a particular risk type, certain market movements can drive volatility in the economic or local regulatory results that may be less significant under IFRS reporting.

Also, Jackson has a significant spread-based business with the significant proportion of its assets invested in fixed income securities and its results are therefore affected by fluctuations in prevailing interest rates. In particular, fixed annuities and stable value products written by Jackson expose Prudential to the risk that changes in interest rates, which are not fully reflected in the interest rates credited to customers, will reduce spread. The spread is the difference between the rate of return Jackson is able to earn on the assets backing the policyholders' liabilities and the amounts that are credited to policyholders in the form of benefit increases, subject to minimum crediting rates. Declines in spread from these products or other spread businesses that Jackson conducts, and increases in surrender levels arising from interest rate rises, could have a material impact on its businesses or results of operations.

A significant part of the profit from M&GPrudential's insurance operations is related to bonuses for policyholders declared on with-profits products, which are broadly based on historical and current rates of return on equity, real estate and fixed income securities, as well as Prudential's expectations of future investment returns. This profit could be lower in a sustained low interest rate environment.

Prudential is subject to the risk of potential sovereign debt credit deterioration owing to the amounts of sovereign debt obligations held in its investment portfolio

Investing in sovereign debt creates exposure to the direct or indirect consequences of political, social or economic changes (including changes in governments, heads of state or monarchs) in the countries in which the issuers are located and the creditworthiness of the sovereign. Investment in sovereign debt obligations involves risks not present in debt obligations of corporate issuers. In addition, the issuer of the debt or the governmental authorities that control the repayment of the debt may be unable or unwilling to repay principal or pay interest when due in accordance with the terms of such debt, and Prudential may have limited recourse to compel payment in the event of a default. A sovereign debtor's willingness or ability to repay principal and to pay interest in a timely manner may be affected by, among other factors, its cash flow situation, its relations with its central bank, the extent of its foreign currency reserves, the availability of sufficient foreign exchange on the date a payment is due, the relative size of the debt service burden to the economy as a whole, the sovereign debtor's policy toward local and international lenders, and the political constraints to which the sovereign debtor may be subject.

Moreover, governments may use a variety of techniques, such as intervention by their central banks or imposition of regulatory controls or taxes, to devalue their currencies' exchange rates, or may adopt monetary and other policies (including to manage their debt burdens) that have a similar effect, all of which could adversely impact the value of an investment in sovereign debt even in the absence of a technical default. Periods of economic uncertainty may affect the volatility of market prices of sovereign debt to a greater extent than the volatility inherent in debt obligations of other types of issuers.

In addition, if a sovereign default or other such events described above were to occur, other financial institutions may also suffer losses or experience solvency or other concerns, and Prudential might face additional risks relating to any debt held in such financial institutions held in its investment portfolio. There is also risk that public perceptions about the stability and creditworthiness of financial institutions and the financial sector generally might be adversely affected, as might counterparty relationships between financial institutions. If a sovereign were to default on its obligations, or adopted policies that devalued or otherwise altered the currencies in which its obligations were denominated this could have a material adverse effect on Prudential's financial condition and results of operations.

Prudential is subject to the risk of exchange rate fluctuations owing to the geographical diversity of its businesses

Due to the geographical diversity of Prudential's businesses, Prudential is subject to the risk of exchange rate fluctuations. Prudential's operations in the US and Asia, which represent a significant proportion of operating profit based on longer-term investment returns and shareholders' funds, generally write policies and invest in assets denominated in local currencies. Although this practice limits the effect of exchange rate fluctuations on local operating results, it can lead to significant fluctuations in Prudential's consolidated financial statements upon the translation of results into pounds sterling. This exposure is not currently separately managed. The currency exposure relating to the translation of reported earnings could impact financial reporting ratios such as dividend cover, which is calculated as operating profit after tax on an IFRS basis, divided by the dividends relating to the reporting year. The impact of gains or losses on currency translations is recorded as a component of shareholders' funds within other comprehensive income. Consequently, this could impact Prudential's gearing ratios (defined as debt over debt plus shareholders' funds). The Group's surplus capital position for regulatory reporting purposes may also be affected by fluctuations in exchange rates with possible consequences for the degree of flexibility that Prudential has in managing its business.

Prudential conducts its businesses subject to regulation and associated regulatory risks, including the effects of changes in the laws, regulations, policies and interpretations and any accounting standards in the markets in which it operates

Changes in government policy and legislation (including in relation to tax), capital control measures on companies and individuals, regulation or regulatory interpretation applying to companies in the financial services and insurance industries in any of the markets in which Prudential operates (including those related to the conduct of business by Prudential or its third party distributors), or decisions taken by regulators in connection with their supervision of members of the Group, which in some circumstances may be applied retrospectively, may adversely affect Prudential. The proposed demerger of M&GPrudential from Prudential plc will result in a change to Prudential's group-wide supervisor to the Hong Kong Insurance Authority, and as a consequence will change the group-wide supervisory framework to which Prudential is subject, the final form of which remains uncertain. The impact from any regulatory changes may affect Prudential's product range, distribution channels, competitiveness, profitability, capital requirements, risk management approaches, corporate or governance structure and, consequently, reported results and financing requirements. Also, regulators in jurisdictions in which Prudential operates may impose requirements affecting the allocation of capital and liquidity between different business units in the Group, whether on a geographic, legal entity, product line or other basis. Regulators may change the level of capital required to be held by individual businesses, the regulation of selling practices, solvency requirements and could introduce changes that impact the products sold. Furthermore, as a result of interventions by governments in light of financial and global economic conditions, there may continue to be changes in government regulation and supervision of the financial services industry, including the possibility of higher capital requirements, restrictions on certain types of transactions and enhanced supervisory powers.

Recent shifts in the focus of some national governments toward more protectionist or restrictive economic and trade policies could impact on the degree and nature of regulatory changes and Prudential's competitive position in some geographic markets. This could take effect, for example, through increased friction in cross-border trade or measures favouring local enterprises such as changes to the maximum level of non-domestic ownership by foreign companies.

The European Union's Solvency II Directive came into effect on 1 January 2016. The measure of regulatory capital under Solvency II is more volatile than under the previous Solvency I regime and regulatory policy may further evolve under the regime. The European Commission began a review in late 2016 of some aspects of the Solvency II legislative package, which is expected to continue until 2021 and includes a review of the Long Term Guarantee measures. Prudential applied for, and has been granted approval by the UK Prudential Regulation Authority to use the following measures when calculating its Solvency II capital requirements: the use of an internal model, the 'matching adjustment' for UK annuities, the 'volatility adjustment' for selected US dollar-denominated business, and UK transitional measures on technical provisions. Prudential also has permission to use 'deduction and aggregation' as the method by which the contribution of the Group's US insurance entities to the Group's solvency is calculated, which in effect recognises surplus in US insurance entities in excess of 250 per cent of local US Risk Based Capital requirements. For as long as Prudential or its businesses remain subject to Solvency II, there is a risk that changes may be required to Prudential's approved internal model or other Solvency II approvals, which could have a material impact on the Group Solvency II capital position. Where internal model changes are subject to regulatory approval, there is a risk that the approval is delayed or not given. In such circumstances, changes in our risk profile would not be able to be appropriately reflected in our internal model, which could have a material impact on the Group's Solvency II capital position.

Currently there are also a number of other global regulatory developments which could impact Prudential's businesses in its many jurisdictions. These include the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) in the US, the work of the Financial Stability Board (FSB) in the area of systemic risk including the designation of Global Systemically Important Insurers (G-SIIs), the Insurance Capital Standard (ICS) being developed by the International Association of Insurance Supervisors (IAIS), the EU Markets in Financial Instruments Directive (the 'MiFID II Directive') and associated implementing measures, which came into force on 3 January 2018 and the EU General Data Protection Regulation, which came into force on 25 May 2018. In addition, regulators in a number of jurisdictions in which the Group operates are further developing local capital regimes; this includes potential future developments under Solvency II in the UK (as referred to above), National Association of Insurance Commissioners' (NAIC) reforms in the US and amendments to certain local statutory regimes in some territories in Asia. There remains a high degree of uncertainty over the potential impact of these changes on the Group.

The Dodd-Frank Act provides for a comprehensive overhaul of the financial services industry within the US including reforms to financial services entities, products and markets. The full impact of the Dodd-Frank Act on Prudential's businesses remains unclear, as many of its provisions are primarily focused on the banking industry, have a delayed effectiveness and/or require rule-making or other actions by various US regulators over the coming years. There is also potential uncertainty surrounding future changes to the Dodd-Frank Act under the current US administration.

Prudential's designation as a G-SII was last reaffirmed on 21 November 2016. The FSB, in conjunction with the IAIS, did not publish a new list of G-SIIs in 2017 and did not engage in G-SII identification for 2018 following IAIS' launch of the consultation on the Holistic Framework (HF) on 14 November 2018, which aims to assess and mitigate systemic risk in the insurance sector and is intended to replace the current G-SII measures. The IAIS intends to implement the HF in 2020 and it is proposed that G-SII identification be suspended from that year. In the interim, the relevant group-wide supervisors have committed to continue applying existing enhanced G-SII supervisory policy measures with some supervisory discretion, which includes a requirement to submit enhanced risk management plans. In November 2022, the FSB will review the need to either discontinue or re-establish an annual identification of G-SIIs in consultation with the IAIS and national authorities. The Higher Loss Absorbency (HLA) standard (a proposed additional capital measure for G-SII designated firms, planned to apply from 2022) is not part of the proposed HF. However, the HF proposes more supervisory powers of intervention for mitigating systemic risk including temporary financial reinforcement measures such as capital add-ons and suspension of dividends.

The IAIS is also developing the ICS as part of ComFrame – the Common Framework for the supervision of Internationally Active Insurance Groups (IAIGs). The implementation of ICS will be conducted in two phases – a five-year monitoring phase followed by an implementation phase. ComFrame will more generally establish a set of common principles and standards designed to assist supervisors in addressing risks that arise from insurance groups with operations in multiple jurisdictions. The ComFrame proposals, including ICS, could result in enhanced capital and regulatory measures for IAIGs, for which Prudential satisfies the criteria.

In late 2018, the US NAIC concluded an industry consultation with the aim of reducing the non-economic volatility in the variable annuity statutory balance sheet and enhancing risk management. The NAIC is targeting a January 2020 effective date for the new framework, which will have an impact on Jackson's business. Jackson continues to assess and test the changes. The NAIC also has an ongoing review of the C-1 bond factors in the required capital calculation, on which further information is expected to be provided in due course. The Group's preparations to manage the impact of these reforms will continue.

On 27 July 2017, the UK FCA announced that it will no longer persuade, or use its powers to compel, panel banks to submit rates for the calculation of LIBOR after 2021. The discontinuation of LIBOR in its current form and its replacement with the Sterling Overnight Index Average benchmark (SONIA) in the UK (and other alternative benchmark rates in other countries) could, among other things, impact the Group through an adverse effect on the value of Prudential's assets and liabilities which are linked to or which reference LIBOR, a reduction in market liquidity during any period of transition and increased legal and conduct risks to the Group arising from changes required to documentation and its related obligations to its stakeholders.

Various jurisdictions in which Prudential operates have created investor compensation schemes that require mandatory contributions from market participants in some instances in the event of a failure of a market participant. As a major participant in the majority of its chosen markets, circumstances could arise in which Prudential, along with other companies, may be required to make such contributions.

The Group's accounts are prepared in accordance with current International Financial Reporting Standards (IFRS) applicable to the insurance industry. The International Accounting Standards Board (IASB) introduced a framework that it described as Phase I which, under its standard IFRS 4 permitted insurers to continue to use the statutory basis of accounting for insurance assets and liabilities that existed in their jurisdictions prior to January 2005. In May 2017, the IASB published its replacement standard on insurance accounting (IFRS 17, 'Insurance Contracts'), which will have the effect of introducing fundamental changes to the statutory reporting of insurance entities that prepare accounts according to IFRS from 2021. In November 2018, the IASB tentatively decided to delay the effective date of IFRS 17 by one year to periods beginning on or after 1 January 2022 and is considering introducing further amendments to this new standard. The European Union will apply its usual process for assessing whether the standard meets the necessary criteria for endorsement. The Group is reviewing the complex requirements of this standard and considering its potential impact. The effect of changes required to the Group's accounting policies as a result of implementing the new standard is currently uncertain, but these changes can be expected to, amongst other things, alter the timing of IFRS profit recognition. Given the implementation of this standard is likely to require significant enhancements to IT, actuarial and finance systems of the Group, it will also have an impact on the Group's expenses.

Any changes or modification of IFRS accounting policies may require a change in the way in which future results will be determined and/or a retrospective adjustment of reported results to ensure consistency.

The implementation of complex strategic initiatives gives rise to significant execution risks, may affect the operational capacity of the Group, and may adversely impact the Group if these initiatives fail to meet their objectives

As part of the implementation of its business strategies, Prudential has commenced a number of significant change initiatives across the Group, many of which are interconnected and/or of large scale, that may have financial, operational, regulatory, customer and reputational implications if such initiatives fail (either wholly or in part) to meet their objectives and could place strain on the operational capacity, or weaken the control environment, of the Group. Implementing further strategic initiatives may amplify these risks. The Group's current significant change initiatives include the combination of M&G and Prudential UK and Europe, the proposed demerger of M&GPrudential and the intended sale of part of the UK annuity portfolio. Significant operational execution risks arise from these initiatives, including in relation to the separation and establishment of standalone governance under relevant regulatory regimes, business functions and processes (data, systems, people) and third party arrangements.

The proposed demerger of M&GPrudential carries with it execution risk and will continue to require significant management attention

The proposed demerger of M&GPrudential is subject to a number of factors and dependencies (including prevailing market conditions, the appropriate allocation of debt and capital between the two groups and approvals from regulators and shareholders). In addition, preparing for and implementing the proposed demerger is expected to continue to require significant time from management, which may divert management's attention from other aspects of Prudential's business.

Therefore there can be no certainty as to the timing of the demerger, or that it will be completed as proposed (or at all). Further, if the proposed demerger is completed, there can be no assurance that either Prudential plc or M&GPrudential will realise the anticipated benefits of the transaction, or that the proposed demerger will not adversely affect the trading value or liquidity of the shares of either or both of the two businesses.

The intended UK exit from the EU may adversely impact economic conditions, increase market volatility, increase political and regulatory uncertainty, and cause operational disruption (including reduced access to EU markets) which could have adverse effects on Prudential's business and its profitability

On 29 March 2017, the UK submitted the formal notification of its intention to withdraw from the EU pursuant to Article 50 of the Treaty on the European Union, as amended. Following submission of this notification, the UK has a maximum period of two years to negotiate the terms of its withdrawal from the EU. If no formal withdrawal agreement is reached between the UK and the EU, then it is expected the UK's membership of the EU will automatically terminate at 11.00pm GMT on 29 March 2019. The UK's decision to leave the EU will have political, legal and economic ramifications for both the UK and the EU, although these are expected to be more pronounced for the UK. The Group has several UK -domiciled operations, principally M&GPrudential, and these will be impacted by a UK withdrawal from the EU, although contingency plans have been developed and enacted since the referendum result to ensure that Prudential's business is not unduly affected by the UK withdrawal. The outcome of the negotiations on the UK's withdrawal and any subsequent negotiations on trade and access to the country's major trading markets, including the single EU market, is currently unknown. As a result, there is ongoing uncertainty over the terms under which the UK will leave the EU, in particular after the transitional period ending in December 2020 (which itself is yet to be agreed in a legally binding manner), and the potential for a disorderly exit by the UK without a negotiated agreement. While the Group has undertaken significant work to plan for and mitigate such risks, there can be no assurance that these plans and efforts will be successful.

In particular, depending on the nature of the UK's exit from the EU, some or all of the following risks may materialise, which may impact the business of the Group and its profitability:

— The UK and EU may experience a downturn in economic activity. The effect of any downturn is expected to be more pronounced for the UK particularly in the event of a disorderly exit by the UK from the EU. Market volatility and illiquidity may increase (including for property funds, where redemption restrictions may be applied) in the period leading up to, and following, the UK's withdrawal. This could lead to potential downgrades in sovereign and corporate debt ratings in the UK and the EU and falls in UK property values. In a severe scenario where the UK's sovereign rating is downgraded by potentially more than one notch, this may also impact on the ratings of UK companies, including Prudential's UK business. Further or prolonged interest rate reductions may occur due to monetary easing. These impacts may result in the adverse effects outlined in the market and general economic conditions risk factor.

— The UK's exit from the EU could result in significant changes to the legal and regulatory regime under which the Group (and, in particular, M&GPrudential) operates, the nature and extent of which remain uncertain while the outcome of negotiations regarding the UK's withdrawal from the EU and the extent and terms of any future access to the single EU market remains to be agreed. There may be an increase in complexity and costs associated with operating in an additional regulatory jurisdiction.

— There may be increased risk of operational disruption to the business, in particular to M&GPrudential. Access to the EU market, and the ability to service EU clients, may be adversely impacted. Negative market sentiment towards the UK from investors may result in negative fund flows and EU service providers may be less willing, or unable to service UK fund managers, both of which may negatively impact on the asset management business of M&GPrudential. The insurance business may experience higher product lapses resulting from fund outflows. The ability to retain and attract appropriately skilled staff from the EU may be adversely impacted. Contractual documentation may need to be renegotiated or redrafted in order to remain effective.

The resolution of several issues affecting the financial services industry could have a negative impact on Prudential's reported results or on its relations with current and potential customers

Prudential is, and in the future may be, subject to legal and regulatory actions in the ordinary course of its business, both in the UK and internationally on matters relevant to the delivery of customer outcomes. Such actions may relate to the application of current regulations for example the Financial Conduct Authority's (FCA) principles and conduct of business rules or the failure to implement new regulations. These actions could involve a review of types of business sold in the past under acceptable market practices at the time, such as the requirement in the UK to provide redress to certain past purchasers of pensions and mortgage endowment policies, changes to the tax regime affecting products, and regulatory reviews of products sold and industry practices, including, in the latter case, lines of business it has closed. Current regulatory actions include the UK insurance business's undertaking to the FCA to review annuities sold without advice after 1 July 2008 to its contract-based defined contribution pension customers. This will result in the UK insurance business being required to provide redress to certain such customers. A provision has been established to cover the costs of undertaking the review and any related redress but the ultimate amount required remains uncertain.

Regulators may also focus on the approach that product providers use to select third-party distributors and to monitor the appropriateness of sales made by them. In some cases, product providers can be held responsible for the deficiencies of third-party distributors.

In the US, there has been significant attention on the different regulatory standards applied to investment advice delivered to retail customers by different sectors of the industry. As a result of reports relating to perceptions of industry abuses, there have been numerous regulatory inquiries and proposals for legislative and regulatory reforms. This includes focus on the suitability of sales of certain products, alternative investments and the widening of the circumstances under which a person or entity providing investment advice with respect to certain employee benefit and pension plans would be considered a fiduciary subjecting the person or entity to certain regulatory requirements. There is a risk that new regulations introduced may have a material adverse effect on the sales of the products by Prudential and increase Prudential's exposure to legal risks.

Litigation, disputes and regulatory investigations may adversely affect Prudential's profitability and financial condition
Prudential is, and may in the future be, subject to legal actions, disputes and regulatory investigations in various contexts, including in the ordinary course of its insurance, investment management and other business operations. These legal actions, disputes and investigations may relate to aspects of Prudential's businesses and operations that are specific to Prudential, or that are common to companies that operate in Prudential's markets. Legal actions and disputes may arise under contracts, regulations (including tax) or from a course of conduct taken by Prudential, and may be class actions. Although Prudential believes that it has adequately provided in all material respects for the costs of litigation and regulatory matters, no assurance can be provided that such provisions are sufficient. Given the large or indeterminate amounts of damages sometimes sought, other sanctions that might be imposed and the inherent unpredictability of litigation and disputes, it is possible that an adverse outcome could have an adverse effect on Prudential's reputation, results of operations or cash flows.

Prudential's businesses are conducted in highly competitive environments with developing demographic trends and continued profitability depends upon management's ability to respond to these pressures and trends
The markets for financial services in the UK, US and Asia are highly competitive, with several factors affecting Prudential's ability to sell its products and continued profitability, including price and yields offered, financial strength and ratings, range of product lines and product quality, brand strength and name recognition, investment management performance, historical bonus levels, the ability to respond to developing demographic trends, customer appetite for certain savings products and technological advances. In some of its markets, Prudential faces competitors that are larger, have greater financial resources or a greater market share, offer a broader range of products or have higher bonus rates. Further, heightened competition for talented and skilled employees and agents with local experience, particularly in Asia, may limit Prudential's potential to grow its business as quickly as planned.

In Asia, the Group's principal competitors include global life insurers such as Allianz, AXA, and Manulife together with regional insurers such as AIA, FWD and Great Eastern, and multinational asset managers such as Franklin Templeton, HSBC Global Asset Management, J.P. Morgan Asset Management and Schroders. In most markets, there are also local companies that have a material market presence.

M&GPrudential's principal competitors include many of the major retail financial services companies and fund management companies including, for example, Aviva, Janus Henderson, Jupiter, Legal & General, Schroders and Standard Life Aberdeen.

Jackson's competitors in the US include major stock and mutual insurance companies, mutual fund organisations, banks and other financial services companies such as Aegon, AIG, Allianz, AXA Equitable Holdings Inc., Brighthouse, Lincoln Financial Group, MetLife and Prudential Financial.

Prudential believes competition will intensify across all regions in response to consumer demand, digital and other technological advances, the need for economies of scale and the consequential impact of consolidation, regulatory actions and other factors. Prudential's ability to generate an appropriate return depends significantly upon its capacity to anticipate and respond appropriately to these competitive pressures.

Downgrades in Prudential's financial strength and credit ratings could significantly impact its competitive position and damage its relationships with creditors or trading counterparties
Prudential's financial strength and credit ratings, which are used by the market to measure its ability to meet policyholder obligations, are an important factor affecting public confidence in Prudential's products, and as a result its competitiveness. Downgrades in Prudential's ratings as a result of, for example, decreased profitability, increased costs, increased indebtedness or other concerns could have an adverse effect on its ability to market products, retain current policyholders, and on the Group's financial flexibility. In addition, the interest rates Prudential pays on its borrowings are affected by its credit ratings, which are in place to measure the Group's ability to meet its contractual obligations.

Prudential plc's long-term senior debt is rated as A2 by Moody's, A by Standard & Poor's and A- by Fitch.

Prudential plc's short-term debt is rated as P-1 by Moody's, A-1 by Standard & Poor's and F1 by Fitch.

The Prudential Assurance Company Limited's financial strength is rated Aa3 by Moody's, A+ by Standard & Poor's and AA- by Fitch.

Jackson's financial strength is rated AA- by Standard & Poor's and Fitch, A1 by Moody's and A+ by A.M. Best.

Prudential Assurance Co. Singapore (Pte) Ltd's financial strength is rated AA- by Standard & Poor's.

All ratings above are on a stable outlook and are stated as at the date of this document.

In addition, changes in methodologies and criteria used by rating agencies could result in downgrades that do not reflect changes in the general economic conditions or Prudential's financial condition.

Adverse experience in the operational risks inherent in Prudential's business, and those of its material outsourcing partners, could disrupt its business functions and have a negative impact on its results of operations

Operational risks are present in all of Prudential's businesses, including the risk (from both Prudential and its outsourcing and external data hosting partners) of direct or indirect loss resulting from inadequate or failed internal and external processes, systems or human error, fraud, the effects of natural or man-made catastrophic events (such as natural disasters, pandemics, cyber-attacks, acts of terrorism, civil unrest and other catastrophes) or from other external events. Exposure to such events could disrupt Prudential's systems and operations significantly, which may result in financial loss and reputational damage.

Prudential's business is dependent on processing a large number of transactions across numerous and diverse products, and it employs a large number of models, and user developed applications, some of which are complex, in its processes. The long-term nature of much of the Group's business also means that accurate records have to be maintained for significant periods. Further, Prudential operates in an extensive and evolving legal and regulated environment (including in relation to tax) which adds to the operational complexity of its business processes and controls.

These factors, among others, result in significant reliance on, and require significant investment in, the information technology (IT) infrastructure, compliance and other operational systems, personnel and processes for the performance of the Group's core business activities. During times of significant change, the operational effectiveness of these components may be impacted.

Although Prudential's IT, compliance and other operational systems, models and processes incorporate controls designed to manage and mitigate the operational and model risks associated with its activities, there can be no assurance that such controls will always be effective. Due to human error among other reasons, operational and model risk incidents do happen periodically and no system or process can entirely prevent them although there have not been any material events to date. Prudential's legacy and other IT systems and processes, as with operational systems and processes generally, may be susceptible to failure or security breaches.

Such events could, among other things, harm Prudential's ability to perform necessary business functions, result in the loss of confidential or proprietary data (exposing it to potential legal claims and regulatory sanctions) and damage its reputation and relationships with its customers and business partners. Similarly, any weakness in administration systems (such as those relating to policyholder records or meeting regulatory requirements) or actuarial reserving processes could have a material adverse effect on its results of operations during the effective period.

In addition, Prudential also relies on a number of outsourcing (including external data hosting) partners to provide several business operations, including a significant part of the UK back office and customer-facing operations as well as a number of IT support functions and investment operations. This creates reliance upon the operational performance of these outsourcing partners, and failure to adequately oversee the outsourcing partner, or the failure of an outsourcing partner (or its key IT and operational systems and processes) could result in significant disruption to business operations and customers.

Attempts to access or disrupt Prudential's IT systems, and loss or misuse of personal data, could result in loss of trust from Prudential's customers and employees, reputational damage and financial loss

Prudential and its business partners are increasingly exposed to the risk that individuals or groups may attempt to disrupt the availability, confidentiality and integrity of its IT systems, which could result in disruption to key operations, make it difficult to recover critical services, damage assets and compromise the integrity and security of data (both corporate and customer). This could result in loss of trust from Prudential's customers and employees, reputational damage and direct or indirect financial loss. The cyber-security threat continues to evolve globally in sophistication and potential significance. Prudential's increasing profile in its current markets and those in which it is entering, growing customer interest in interacting with their insurance providers and asset managers through the internet and social media, improved brand awareness and the classification of Prudential as a G-SII could also increase the likelihood of Prudential being considered a target by cyber criminals. Further, there have been changes to the threat landscape and the risk from untargeted but sophisticated and automated attacks has increased.

There is an increasing requirement and expectation on Prudential and its business partners, to not only hold customer, shareholder and employee data securely, but use it in a transparent and appropriate way. Developments in data protection worldwide (such as the implementation of EU General Data Protection Regulation that came into force on 25 May 2018) may also increase the financial and reputational implications for Prudential following a significant breach of its (or its third-party suppliers') IT systems. To date, Prudential has not identified a failure or breach, or an incident of data misuse, which has had a material impact in relation to its legacy and other IT systems and processes. However, it has been, and likely will continue to be, subject to potential damage from computer viruses, attempts at unauthorised access and cyber-security attacks such as 'denial of service' attacks (which, for example, can cause temporary disruption to websites and IT networks), phishing and disruptive software campaigns.

Prudential is continually enhancing its IT environment to remain secure against emerging threats, together with increasing its ability to detect system compromise and recover should such an incident occur. However, there can be no assurance that such events will not take place which may have material adverse consequential effects on Prudential's business and financial position.

The failure to understand and respond effectively to the risks associated with environmental, social or governance (ESG) factors could adversely affect Prudential's achievement of its long term strategy

The business environment in which Prudential operates is continually changing. ESG-related issues may directly or indirectly impact key stakeholders, ranging from customers to institutional investors, employees, suppliers and regulators, all of whom have expectations in this area. A failure to manage those material risks which have ESG implications may adversely impact on the reputation and brand of the Group, the results of its operations, its customers, and its ability to deliver on its long-term strategy and therefore its long-term success.

Climate change is one ESG theme that poses potentially significant risks to Prudential and its customers, not only from the physical impacts of climate change, driven by both specific short-term climate-related events such as natural disasters and longer-term impacts, but also from transition risks associated with the shift to a low carbon economy. Climate-driven changes in countries in which Prudential operates could change its claims profile. There is an increasing expectation from stakeholders for Prudential to understand, manage and provide increased transparency of its exposure to climate-related risks. For example, the FSB's Task Force on Climate-related Disclosures recommendations were published in 2017 to provide a voluntary framework on corporate climate-related financial disclosures following the FSB's concern that there may be systemic risk in the financial system related to climate change.

As governments and policymakers take action to reduce greenhouse gas emissions and limit global warming, the transition to a low carbon economy could have an adverse impact on global investment asset valuations whilst at the same time present investment opportunities which the Group will need to monitor. In particular, there is a risk that this transition could result in some asset sectors facing significantly higher costs and a disorderly adjustment to their asset values. This could lead to an adverse impact on the value and the future performance of the investment assets of the Group. The potential broader economic impact from this may impact upon customer demand for the Group's products. Given that Prudential's investment horizons are long term, it is potentially more exposed to the long-term impact of climate change risks. Additionally, Prudential's stakeholders increasingly expect responsible investment principles to be adopted to demonstrate that ESG considerations (including climate change) are effectively integrated into investment decisions and fiduciary and stewardship duties.

Adverse experience relative to the assumptions used in pricing products and reporting business results could significantly affect Prudential's results of operations

In common with other life insurers, the profitability of the Group's businesses depends on a mix of factors including mortality and morbidity levels and trends, policy surrenders and take-up rates on guarantee features of products, investment performance and impairments, unit cost of administration and new business acquisition expenses. The Group's businesses are subject to inflation risk. In particular, the Group's medical insurance businesses in Asia are also exposed to medical inflation risk.

Prudential needs to make assumptions about a number of factors in determining the pricing of its products, for setting reserves, and for reporting its capital levels and the results of its long-term business operations. For example, the assumption that Prudential makes about future expected levels of mortality is particularly relevant for its UK annuity business, where payments are guaranteed for at least as long as the policyholder is alive. Prudential conducts rigorous research into longevity risk, using industry data as well as its own substantial annuitant experience. As part of its pension annuity pricing and reserving policy, Prudential's UK business assumes that current rates of mortality continuously improve over time at levels based on adjusted data and informed by models from the Continuous Mortality Investigation (CMI) as published by the Institute and Faculty of Actuaries. Assumptions about future expected levels of mortality are also of relevance to the Guaranteed Minimum Withdrawal Benefit (GMWB) of Jackson's variable annuity business. If mortality improvement rates significantly exceed the improvement assumed, Prudential's results of operations could be adversely affected.

A further factor is the assumption that Prudential makes about future expected levels of the rates of early termination of products by its customers (known as persistency). This is relevant to a number of lines of business in the Group, especially for Jackson's portfolio of variable annuities. Prudential's persistency assumptions reflect a combination of recent past experience for each relevant line of business and expert judgement, especially where a lack of relevant and credible experience data exists. Any expected change in future persistency is also reflected in the assumption. If actual levels of future persistency are significantly different than assumed, the Group's results of operations could be adversely affected. Furthermore, Jackson's variable annuity products are sensitive to other types of policyholder behaviour, such as the take-up of its GMWB product features.

In addition, Prudential's business may be adversely affected by epidemics and other effects that give rise to a large number of deaths or additional sickness claims, as well as increases to the cost of medical claims. Significant influenza and other epidemics have occurred a number of times historically but the likelihood, timing, or the severity of future epidemics cannot be predicted. The effectiveness of external parties, including governmental and non-governmental organisations, in combating the spread and severity of any epidemics could have a material impact on the Group's loss experience.

As a holding company, Prudential is dependent upon its subsidiaries to cover operating expenses and dividend payments

The Group's insurance and investment management operations are generally conducted through direct and indirect subsidiaries, which are subject to the risks discussed elsewhere in this 'Risk Factors' section.

As a holding company, Prudential's principal sources of funds are remittances from subsidiaries, shareholder-backed funds, the shareholder transfer from long-term funds and any amounts that may be raised through the issuance of equity, debt and commercial paper.

Certain of Prudential's subsidiaries are subject to applicable insurance, foreign exchange and tax laws, rules and regulations that can limit their ability to make remittances. In some circumstances, this could limit Prudential's ability to pay dividends to shareholders or to make available funds held in certain subsidiaries to cover operating expenses of other members of the Group.

Prudential operates in a number of markets through joint ventures and other arrangements with third parties, involving certain risks that Prudential does not face with respect to its consolidated subsidiaries

Prudential operates, and in certain markets is required by local regulation to operate, through joint ventures and other similar arrangements. For such Group operations, management control is exercised in conjunction with other participants. The level of control exercisable by the Group depends on the terms of the contractual agreements, in particular, the allocation of control among, and continued cooperation between, the participants. In addition, the level of control exercisable by the Group could also be subject to changes in the maximum level of non-domestic ownership imposed on foreign companies in certain jurisdictions. Prudential may face financial, reputational and other exposure (including regulatory censure) in the event that any of its partners fails to meet its obligations under the arrangements, encounters financial difficulty, or fails to comply with local or international regulation and standards such as those pertaining to the prevention of financial crime. In addition, a significant proportion of the Group’s product distribution is carried out through arrangements with third parties not controlled by Prudential and is therefore dependent upon continuation of these relationships. A temporary or permanent disruption to these distribution arrangements, such as through significant deterioration in the reputation, financial position or other circumstances of the third party or material failure in controls (such as those pertaining to the third-party system failure or the prevention of financial crime) could adversely affect the results of operations of Prudential.

Prudential’s Articles of Association contain an exclusive jurisdiction provision

Under Prudential’s Articles of Association, certain legal proceedings may only be brought in the courts of England and Wales. This applies to legal proceedings by a shareholder (in its capacity as such) against Prudential and/or its directors and/or its professional service providers. It also applies to legal proceedings between Prudential and its directors and/or Prudential and Prudential’s professional service providers that arise in connection with legal proceedings between the shareholder and such professional service providers. This provision could make it difficult for US and other non-UK shareholders to enforce their shareholder rights.

Changes in tax legislation may result in adverse tax consequences

Tax rules, including those relating to the insurance industry, and their interpretation may change, possibly with retrospective effect, in any of the jurisdictions in which Prudential operates. Significant tax disputes with tax authorities, and any change in the tax status of any member of the Group or in taxation legislation or its scope or interpretation could affect Prudential’s financial condition and results of operations.