# Prudential Corporation
## Annual Report 1998

## Contents

# Our Purpose

Prudential Corporation, through its businesses in Europe, the US and Asia, provides retail financial products and services and fund management to many millions of customers worldwide.

Our commitment to the shareholders who own Prudential is to maximise the value over time of their investment. We do this by investing for the long term to develop and bring out the best in our people and our businesses to produce superior products and services, and hence superior financial returns. Our aim is to deliver top quartile performance within the FTSE 100 in terms of total shareholder returns.

At Prudential our aim is lasting relationships with our customers and policyholders, through products and services that offer value for money and security. We also seek to enhance our Company's reputation, built over 150 years, for integrity and for acting responsibly within society.

# Group Financial Highlights

| | 1998 £m | 1997 £m |
|---|---|---|
| Operating profit (including longer term investment returns) | | |
| United Kingdom | | |
| Prudential Retail Financial Services | **333** | 323* |
| Retail IFA | **92** | 72 |
| Prudential Fund Management | **50** | 49 |
| Egg and Prudential Banking | **(77)** | (22) |
| **Total** | **398** | 422* |
| Jackson National Life | **411** | 367 |
| Prudential Asia | **13** | 11 |
| Shareholders' other income | **38** | 34* |
| **Total continuing operations** | **860** | 834* |
| Discontinued operations | **8** | 30 |
| **Total operating profit** | **868** | 864* |
| Short-term fluctuations in investment returns | **24** | 83* |
| Profit on business disposals | **249** | 18 |
| Reclassification of shareholder reserves of Australian operation | **–** | 204 |
| Profit before tax (including actual investment returns) | **1,141** | 1,169 |
| Operating earnings per share | **33.7p** | 32.0p* |
| Total earnings per share | **45.3p** | 43.3p |
| Dividend per share | **21.0p** | 19.1p |
| Achieved profits basis shareholders' funds | **£7.5bn** | £6.9bn |
| Funds under management | **£128bn** | £119bn |

* Restated for the change in accounting policies

Prudential Corporation at a glance

PPMWORLDWIDE

PPM is the fund management arm of Prudential. It is one of the UK's largest investment managers with a total of £128 billion of funds under management. It controls four per cent of UK equities and is the UK's largest property investment manager. PPM's disciplined, research-based, active value investment philosophy is applied consistently through its network of investment professionals located around the world.

- PPM employs in total 1,400 people in seven countries around the world with offices in London, Cape Town, Chicago, New York, Hong Kong, Singapore and Tokyo.
- Assets are managed locally, bringing benefit of local knowledge and expertise.
- Prudential's with-profits fund is PPM's largest client fund and is the largest investment fund in the UK.
- PPM investment services and products include pension funds (segregated and pooled), unit trusts, PEPs, currency funds and unit linked life and pension funds.
- PPM offers specialist management in equities (UK and international), Government and Corporate bonds, overseas equities, fixed interest, tactical asset allocation and property.
- PPM was voted Best Fund manager by the finance directors of the top 350 UK companies in the 1998 Extel Survey of Investment Analysts.
- A new office was opened in Tokyo strengthening commitment to the Asian market.
- Funds managed by PPM in Japan and the Far East won the 1998 Best Performance Award from S&P/Micropal.

International

PRUDENTIAL
英国保诚保险

Prudential Corporation Asia (PCA) has operations in Hong Kong, Singapore, Malaysia, Thailand, Indonesia, Philippines and India. It also has representative offices in five cities in China and offices in Hanoi and Ho Chi Minh City in Vietnam. Prudential continues to be the largest UK life insurer in the region.

- PCA has over 14,000 agents, 1,350 staff and £1.7 billion funds under management.
- PCA offers a comprehensive range of savings, investment and protection products.
- Products are tailored to the needs of the local markets. These include a range of bancassurance products and products designed for specific target segments, e.g. young families.
- PCA re-entered the Indian market after a 42-year absence, with the successful launch of a joint venture with ICICI in the mutual fund business.
- PCA took a majority shareholding in its Malaysian business, which is one of the top three life insurers in this market.
- In Indonesia PCA pioneered a bancassurance initiative with joint venture partner Bank Bali.
- An agreement was signed in December 1998 with Standard Chartered Bank to sell life insurance products to its customers, initially in Singapore and Hong Kong.

Asia

# Prudential Corporation

Egg – a radical new direct service – was launched in October 1998. It creates individual solutions for customers, tailored exclusively to their specific financial needs.

Egg is one of the first financial services organisations to make comprehensive use of the Internet on a fully integrated basis. It is focused on the Internet generation and represents a major stake in the fast growing e-commerce market. Egg is open for business 24 hours a day, seven days a week.

- Egg now has over 250,000 savings account customers.
- Within five months of launch Egg had taken £3 billion in deposits.
- Over 350,000 people visited Egg's website at *www.egg.com* with 1.75 million Internet hits in the first week.
- Egg and Prudential Banking combined now employ around 1,200 people.
- Egg's main products are a savings account with a guarantee linked to the Bank of England base rate, mortgages, personal loans and insurance.
- Each product is easy to understand, flexible, and offers market leading rates, with no hidden fees, charges and no commission.
- Egg was launched with a major TV advertising campaign.
- A second phase of Internet developments has been launched including 'Online servicing' for savings customers; an online financial bookshop and an 'e-Forum' to encourage customers to discuss various topics online.

Founded in 1826, Scottish Amicable was acquired by Prudential in 1997. As Prudential's lead IFA brand Scottish Amicable aims to provide Independent Financial Advisers with competitive, flexible products that meet the requirements of their clients.

- Scottish Amicable has over two million customers.
- Its products are sold through IFAs and Appointed Representatives.
- Around 2,500 people are employed by Scottish Amicable throughout the United Kingdom.
- Scottish Amicable's award winning product range covers: pensions, savings and investments, mortgage repayment, life assurance/protection and long-term care.
- Scottish Amicable's Home Purchaser endowment and Scottish Amicable European's Long-Term Care Bond received top ratings as best products in leading IFA awards.
- Standard and Poor's, the ratings agency, awarded Scottish Amicable its highest rating – AAA – for financial strength.
- Scottish Amicable regained its five star service award in the Life and Pension category of Financial Adviser's awards. These are voted for by IFA customers.
- Scottish Amicable offers financial advisers and their clients the power to choose from six of the UK's leading fund managers.
- A £15 million investment at Scottish Amicable's headquarters at Craigforth, is resulting in the creation of 500 new jobs to support the company's ambitious business plans over the next 18 months.

PRUDENTIAL

Prudential Retail Financial Services comprises four business units: Prudential Retail, Life and Pensions, General Insurance, and Prudential Annuities.

- Prudential employs around 10,000 people in the UK, including a 3,000 strong direct salesforce.
- Prudential has six million customers in the UK – one in six of the adult population.
- Prudential is Britain's biggest pensions provider with around two million pension contracts.
- The majority of Prudential's premiums come from life insurance, pensions and savings plans. There are 7.8 million Prudential life policies in force in the UK.
- Prudential is the largest provider of pension annuity business in the UK offering a range of products including level or fixed increase annuities, RPI linked annuities, with-profits and bulk purchase annuities.
- In the UK Prudential provides retail general insurance cover for around 1.5 million homes and around 200,000 cars.
- Prudential is the leading UK provider of annuities with sales of in excess of £1 billion.
- Phase I of the pensions review was completed on time.
- Direct salesforce recruitment was recommenced in December.

Jackson National Life Insurance Company

*Insuring your financial future.*™

Jackson National Life (JNL), was acquired by Prudential in 1986. Diversification has been central to JNL's strategy over the last few years and in 1998 some three quarters of single premium sales were generated by products not in existence four years ago.

- JNL currently has 1.8 million existing policies and US$35 billion in funds under management.
- Jackson employs over 1,500 people in the US with service centres in Lansing and Denver.
- In 1996 JNL entered the index annuity market and now it is the third largest selling index annuity provider in the US.
- JNL has the seventh largest block of stable value business (Guaranteed Investment Contracts and Funding Agreements) in the industry after only three years in the business.
- JNL also provides life assurance products and is a market leader in fixed and variable annuities.
- JNL attained record operating profit of US$679 million and near record sales in 1998.
- Sales of new equity index annuity products of US$469 million.
- Three upgrades received from rating agencies: Moody's Investors Services, from A1 to Aa3; A.M. Best from A (Excellent) to A+ (Superior); and Duff & Phelps from AA to AA+.
- Opened for business in New York State. JNL now has products and services in all 50 states.
- First Federal Savings and Loan Associations of San Bernardino was acquired allowing JNL to offer banking products.

US

# Chairman's Statement

Prudential's 150th year has been marked by great change both in the shape of our business and in the financial services market-place.

Underlying operating profit from our continuing operations around the world, before taking into account the investment in Egg, our new direct service and in Prudential Banking, rose by nine per cent in 1998. This result reflects particularly strong performances by Jackson National Life in the US and our IFA business in the UK. Given these results and our confidence in the continuing expansion of our business, the Board has decided to increase the final dividend by ten per cent to 21 pence per share.

As a result of the changes we have made, the business is now clearly focused on developing retail financial services and fund management activities in our chosen markets.

Our US business has continued to deliver a strong result, despite difficult conditions. We have sold our businesses in Australia and New Zealand on advantageous terms but remain committed to our business in Asia, since we believe that this economy will emerge with renewed vigour from the recent turmoil before too long.

The roots upon which Prudential was founded 150 years ago lay in the desire to help secure the financial futures of the working population. With people today living longer and with greater responsibility resting with individuals rather than the state, securing a comfortable retirement is becoming a more urgent priority. Prudential welcomes the Government's efforts to encourage individuals to make greater self-provision, and has participated fully in the process of developing a sound framework to support this objective.

Since the end of the last financial year we have announced our offer for M&G, one of the best known brands in the retail fund management business, in order to expand our business in that field.

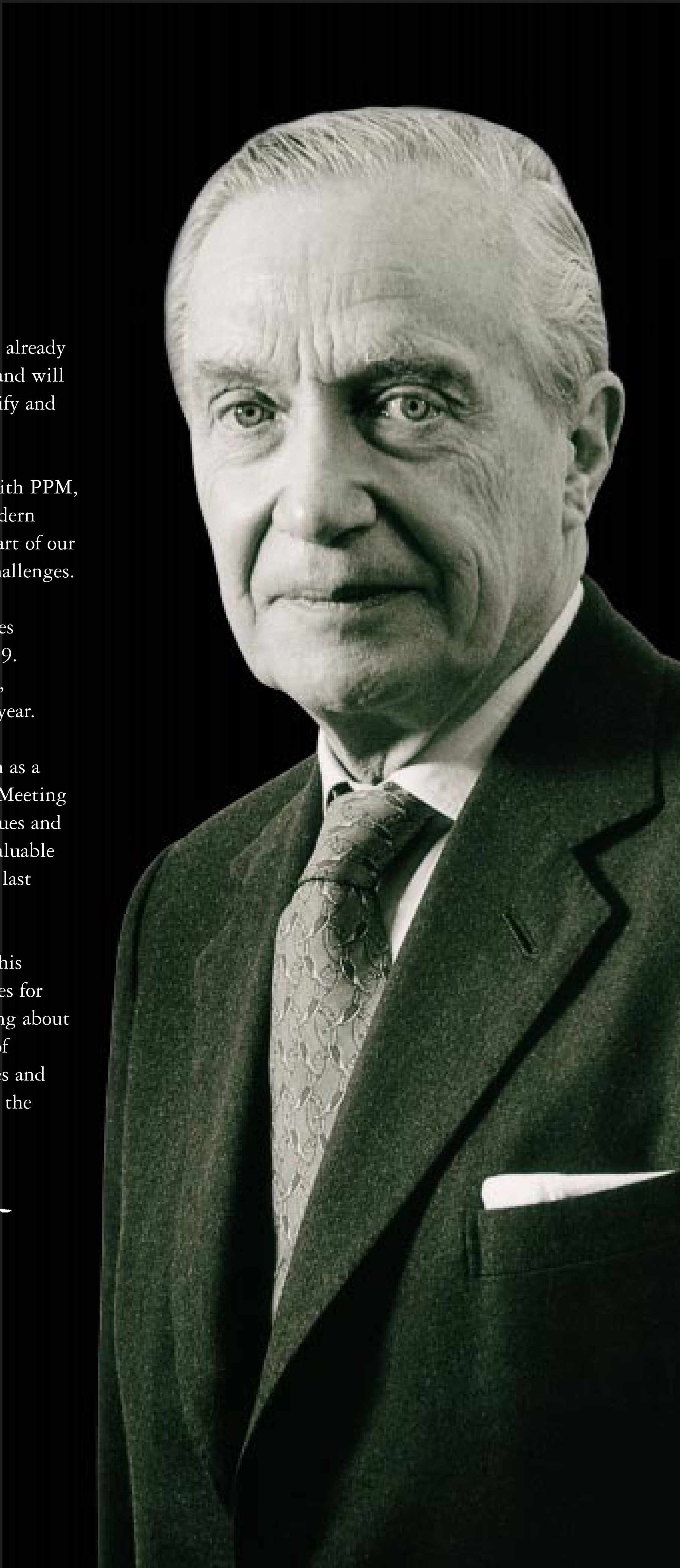
The decline in the rate of inflation has been a powerful influence on our markets in recent years, and today low inflation rates are a feature of most developed economies. This has led inevitably to a marked reduction in interest rates – a trend that is likely to continue.

Lower interest rates tend to drive the capital value of financial assets higher; hence the strong equity and bond markets. But while increased capital values provide a one-time gain, the lower yields persist. Lower prospective yields are now a feature of all savings vehicles. In the case of UK life insurance products, reversionary bonuses will thus be lower. However, these lower yields should be seen against the background of the much more favourable lower rate of inflation.

At the front of this report we set out our new statement of business purpose. As you will see, it focuses clearly on shareholder value – everything we do must be directed towards increasing that value through our products, our services and our staff. The value of the company will grow only if we also increase its value to our customers by continuously providing innovative and competitive products and services in new customer-friendly ways. Putting the customer first is the best route to increasing shareholder value.

Last year we reported on our progress with negotiations over the attribution of our orphan estate. Those negotiations, initially with the Department of Trade and Industry and then the Treasury, have proved complex and, since January 1999 have been the responsibility of the Financial Services Authority. You can be assured of our best efforts to resolve the issue.

I am pleased to report that Prudential has successfully completed the first phase of the pensions review on time. All priority cases falling within the scope of the review were dealt with by the end of 1998. As I have stated in previous reports, we have committed considerable resources to ensure the speedy resolution of the matter



and the restoration of our reputation. We have already embarked on the second phase of the exercise and will continue to work with our regulators to simplify and accelerate the process.

In April the head office of Prudential, along with PPM, will be moving to a new smaller but more modern office in the City. This is another significant part of our evolution which will help us to meet future challenges.

As announced during the year, Sir David Barnes CBE joined the Board at the beginning of 1999. Mr Michael Abrahams, Deputy Chairman, has, I am glad to say, agreed to serve for one more year.

Niall FitzGerald is not standing for re-election as a non-executive director at the Annual General Meeting following two terms on the Board. My colleagues and I would like to thank him for the extremely valuable contribution he has made to Prudential in the last six years.

Finally, my thanks are due to Sir Peter Davis, his management team and all Prudential employees for their successful efforts during the year. Bringing about major change within an organisation the size of Prudential is no easy task. My Board colleagues and I are wholeheartedly committed to supporting the executive in the challenges ahead.

Martin W. Jacomb

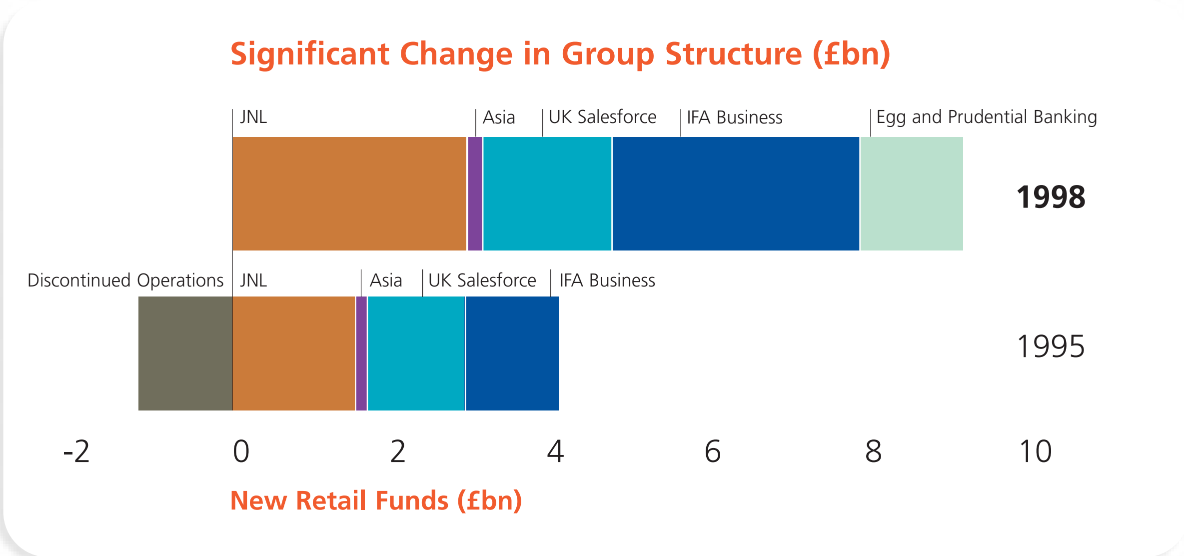
Sir Martin Jacomb
Chairman

# Group Chief Executive's Review

Three years ago we redefined Prudential's strategy to concentrate our activities on retail financial services and fund management in our chosen markets. During this time we have therefore disposed of businesses which were either not core activities or which did not attain critical mass in their operations. This year we sold our businesses in Australia and New Zealand taking advantage of a consolidating market and realising a price twice its embedded value. Over the last three years we have disposed of businesses that made up almost one quarter of our new funds and have more than doubled the size of our ongoing operations.

In retail financial services we have concentrated on expanding our distribution capability and broadening our product range to give our customers choice. Our main distribution channel in 1995 – in the UK, US and Asia – was largely salesforce-based delivering £2.5 billion retail funds, two-thirds of our total. Our concern was that we were overdependent on this one particular channel and our exposure to alternative channels was poor. In 1998 our salesforces again delivered £2.5 billion of funds but this represents only 30 per cent of new Group funds. This significant increase in total new business flows came from growth in funds from other channels. We very much believe that salesforces have great strengths with the capability of providing a unique service of face to face advice at a location and time of the customer's choosing.

At the same time I should say that I am very pleased with the progress we are making in moving Prudential's salesforce in the UK towards an integrated marketing operation. Crucial to this have been proposals for a revised remuneration package which places much greater emphasis and reward on customer retention and satisfaction.




However, the other main thrust has been to grow funds coming from other channels. Funds from UK IFAs and brokers in the US this year totalled £3.5 billion – more than treble 1995's total. This growth reflects the full-year contribution of Scottish Amicable and the continued success of Prudence Bond in the UK. During the year we have integrated our existing IFA business with that of Scottish Amicable under one management team. This year its weighted sales are up 28 per cent accounting for 60 per cent of UK sales. Scottish Amicable is performing ahead of our original acquisition assumptions.

In the US we have built up a broker marketing team and launched our own broker dealer National Planning Corporation. Sales through brokers in the US totalled US$0.75 billion in 1998 compared with negligible levels in 1995. Sales through US banks have also increased over the same period by 43 per cent to just under half a billion dollars. Our strategy of positioning Jackson National Life to compete in a range of economic conditions has been tested and found successful.

In Asia we have started a bancassurance operation in Indonesia with our partner Bank Bali. Recently we announced an important co-operation agreement with Standard Chartered whereby we locate our agents in Standard Chartered branches in Hong Kong and Singapore to sell Prudential life products.

Our latest distribution channel is e-commerce and we are doing a lot of work in this area across the Group. While Egg has been exceptionally popular and has certainly hit the headlines in the UK, we are also active in the intermediary markets at Jackson, Scottish Amicable and within Prudential Corporate. We are very pleased with Egg and have, to date, attracted over £3 billion in deposits through 250,000 deposit accounts.

An equally key priority has been to broaden our product range by acquisition and organic initiatives. Nearly half the products we sold in 1998 were not sold by us three years ago.

In the UK we have expanded our IFA product range significantly. Our acquisition of Scottish Amicable has

# Group Chief Executive's Review

delivered a good complementary range of regular premium and pensions products.

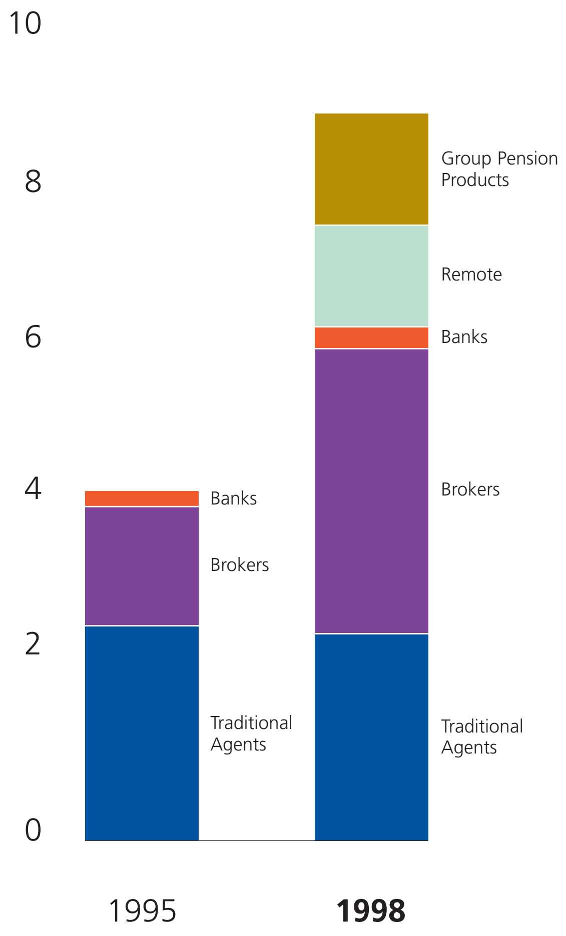
We also created Prudential Banking to deliver banking and mortgage products to our customers. Our direct business, Egg, provides a new delivery channel for a wide range of financial products and services. Egg epitomises Prudential's strategy of broadening our product ranges, improving customer access and positioning the business to anticipate and respond to changing consumer needs. The success of Egg and the continuing high valuations of branch based networks means that we no longer see any value in acquiring a bank or a building society.

In the US we have expanded our range to include equity based products and group pension schemes. This diversification has allowed Jackson to continue its successful contribution to the Group result despite the impact of the current low interest rates which affect sales of their traditional fixed annuities. Sales volumes came close to matching last year's record total despite difficult economic conditions while profit once again reached record levels.

In the UK we have this year grouped together our investment-led business – Prudential Corporate, Collectives and our fund management company, PPM – to accelerate growth.

Another important development this year in the UK is that of offering our customers a choice of fund management. This has been a feature of Jackson's variable annuity products and recently we have launched a similar initiative in Scottish Amicable. Its pension products now feature a choice of six fund managers, including PPM, with a choice of ten new funds. This will be extended to Scottish Amicable's ISAs and we believe that this extra choice to customers will be well received.

**Expanding Distribution (£bn)**

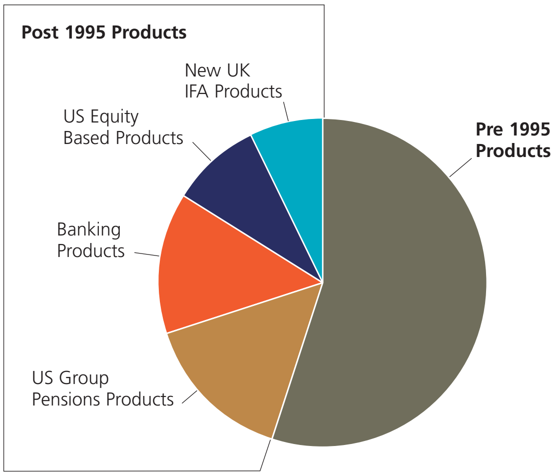


We believe that it is imperative for our business units to be capable of realising the benefits of these product and distribution channel initiatives and to be able to move quickly to anticipate and respond to change.

Our US and Asia operations were already structured to deliver these goals. But the single entity of our UK business was not suited to today's rapidly changing environment. Hence the decision last year to restructure it. We are already reaping significant benefits from the new UK structure with tremendous energy being released in our new highly focused business units.

Following the restructuring we have now introduced value-based management into all our UK units. This will help us in implementing clear value creation goals and accountabilities in the new business units.

**1998 Product Range**
**£8.9bn of New Retail Funds**




The need to update and expand our product ranges is an ongoing priority. We believe that the global trend towards investment products – such as 401K plans and mutual funds – will continue and will become the dominant basis for future saving and pension plans in the UK and Europe.

On 11 March 1999, we announced the terms of a recommended cash offer for M&G subject to regulatory and other approvals. This acquisition of the leading UK unit trust business and brand will significantly enhance Prudential's retail fund management capabilities, will give us a further £18.5 billion funds under management, and will strengthen Prudential's position in the IFA and direct markets. The enlarged Group will be positioned for further growth in fund management, in particular the launch of ISAs and, in due course, stakeholder pensions in the UK.

We hope that regulatory clearance for this acquisition will be received by the end of July 1999.

Looking towards the year ahead we have a range of strong brands, some exciting product opportunities and a diverse spread of channels. We are now customer focused and go forward with confidence.

Sir Peter Davis
Group Chief Executive

# US

## Jackson National Life Insurance Company

*Insuring your financial future.™*

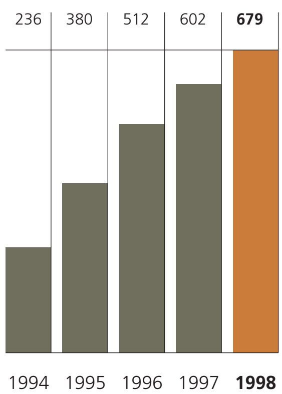
**"New products and new distribution channels have given customers wider access to our services." Bob Saltzman, Chief Executive Officer, Jackson National Life.**

For Jackson National Life, 1998 demonstrated the effectiveness of its strategy of diversification. Low interest rates reduced the attractiveness of Jackson's traditional fixed annuity products, whilst volatile equity markets and aggressive competitor pricing tactics dampened demand for Jackson's newer variable and equity-linked indexed annuities. Despite these factors, JNL was able to achieve record profits and near-record sales. Operating profit for the year totalled US$679 million and funds under management have increased by US$4 billion to total US$35 billion.

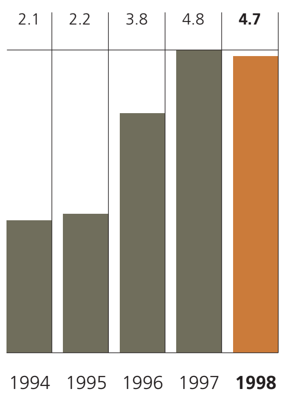
Anticipating changes in the US market, we have been developing new product lines and creating new distribution channels. Indeed, in 1998, roughly three quarters of JNL's sales of US$4.7 billion came from products not in existence four years ago.

### Sales

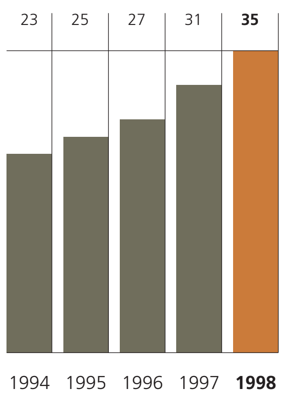
Our 1998 sales were fuelled by two successful new equity-based annuities. JNL entered the index annuity market in 1996 with the Equity Linked Index Annuity (ELI) which has been one of JNL's most successful product launches ever and is now the number three selling index annuity in the country. Additionally, ELITE 500, another equity index annuity, was



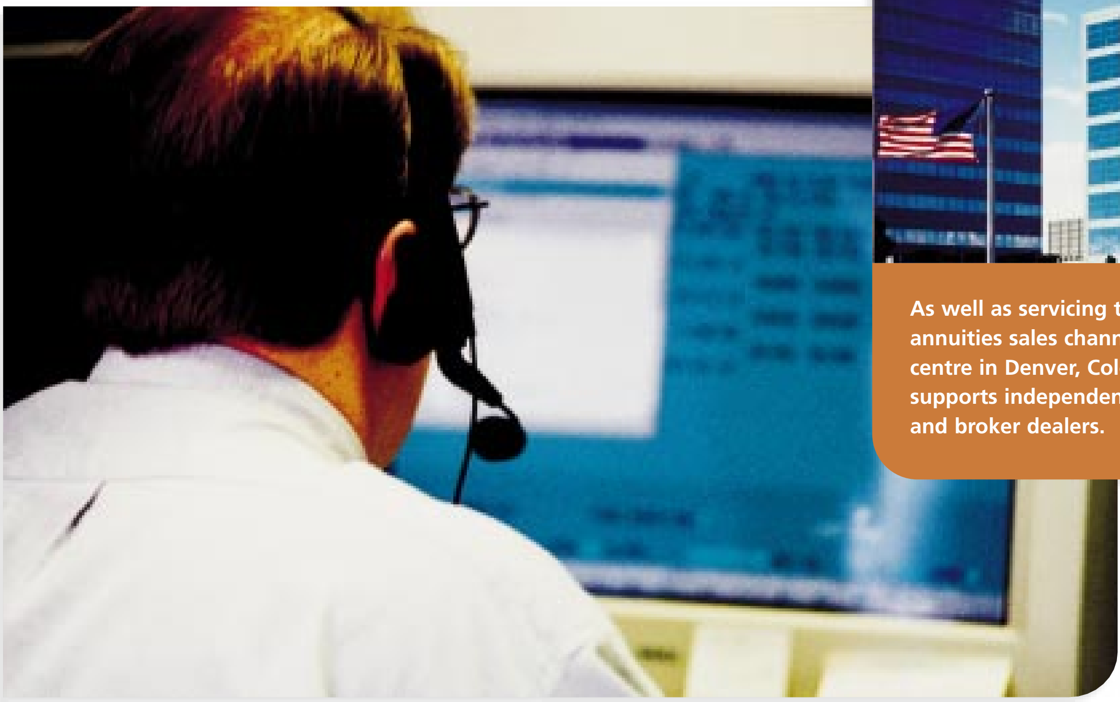

**Operating Profit (US$m)**




**Single Premium Sales (US$bn)**




**Funds Under Management (US$bn)**



**As well as servicing the variable annuities sales channel, Jackson's call centre in Denver, Colorado also supports independent agents, banks and broker dealers.**

introduced in 1998. Sales of US$469 million demonstrate the appeal of these two products. A further initiative during 1998 was the Perspective Advisors Fixed and Variable Annuity, a new variable annuity with a range of innovative features.

Sales of our stable value products – Guaranteed Investment Contracts (GICs) and Funding Agreements – increased with US$2.2 billion in new contracts issued. Jackson National's name has become well recognised in only its third year in this market. In fact, JNL now has the seventh largest block of stable value business in the industry.

## New Developments

Diversification has helped us reach more customers, has given Jackson National an added dimension of strength and stability, and caught the attention of the ratings agencies. As a result, Jackson National earned three ratings upgrades in just over a year: Moody's Investors Service, from A1 to Aa3; A.M. Best from A (Excellent) to A+ (Superior); and Duff & Phelps, from AA to AA+. Duff & Phelps cited JNL's 'considerable progress toward expansion, diversifying product and distribution, and improving capitalisation,' as reasons for the upgrade.

As well as developing new products to meet customer requirements, we have developed new channels to provide wider access to our services. Technology is the driving force for better service across all of our distribution channels: we continue to expand our Web site to provide increasing amounts of information for both consumers and agents and our service centres in Lansing and Denver have again upgraded technology.

During the year Jackson completed its coverage in all 50 states when it opened for business in the state of New York. Jackson also launched its own broker-dealer, National Planning Corporation and acquired a small independent broker-dealer, SII Investments, Inc. The acquisition of a small US Savings & Loans institution (renamed Jackson Federal Savings Bank) will, in due course, enable Jackson to offer a range of banking products through a federally chartered banking subsidiary.

With so much new business and steady growth during the last five years, JNL has outgrown its current building and expects to move into a new headquarters in Lansing by the end of the year 2000. In February, JNL broke ground on a new state-of-the-art complex that will consolidate six business sites into one comprehensive location.

Going forward, our diversification strategy is likely to include the acquisition of blocks of business or entire companies with complementary product lines and distribution channels – to strengthen still further our resilience to economic cycles.

# Asia

**"We are well placed to take advantage of opportunities to access more customers in new and innovative ways." Mark Tucker, Chief Executive, Prudential Asia.**

Prudential Asia has operations in seven countries in the region, having re-entered India in 1998 after a 42 year absence, with the very successful launch of our joint venture with ICICI in the mutual fund business. We also have representative offices in five cities in China and offices in Hanoi and Ho Chi Minh City in Vietnam. Prudential continues to be the largest UK life insurer in the region with over 14,000 agents, 1,350 staff and £1.7 billion funds under management.

1998 saw a continuation of the regional economic turmoil that began in July 1997, though the stock and currency markets regained some ground towards the end of 1998. There are some very good opportunities emerging from the liberalisation effects of the recent economic upheaval and Prudential is well positioned to take advantage of these.

## Sales and Profit

Economic conditions impacted on sales as customers were less able to commit to medium and long-term savings plans. Annual premium sales were £79 million in 1998, down from the record levels of £120 million in 1997. Single insurance premium sales decreased to £42 million for the year compared to the exceptional level of £226 million in 1997, which had been fuelled by the one-off effect of the Central Provident Fund (CPF) liberalisation in Singapore.

Prudential's experience across the region has generally been in line with that of the industry. Overall, we have generally maintained or increased our market shares. In Singapore the Company has now captured the second largest market share in new annual premium business. This is the highest ranking we have ever achieved in this market sector.

Statutory operating profit for 1998 of £23 million (before development costs of £10 million) is 15 per cent ahead of 1997. New business achieved profits, which show the value added by sales, once again exceeded £50 million.

## New Developments

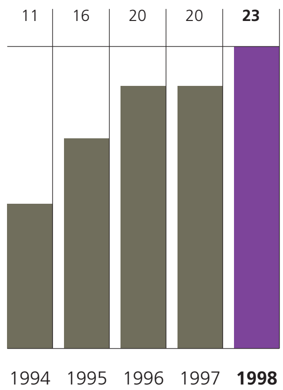
The Asian crisis has provided opportunities for Prudential to expand its presence in the region.
A major review of the Asian retail financial services markets was undertaken during 1998 which, amongst other factors, took into consideration the changing

regulatory and market environments. The initiatives arising from the review will unfold during the next few years, but some significant developments have already taken place.

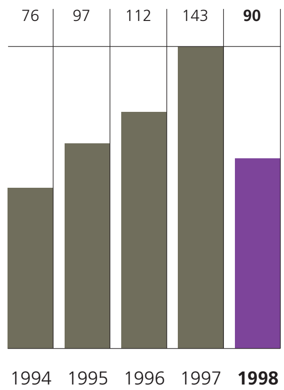
We acted swiftly to take advantage of changes in the rules governing foreign ownership by increasing our shareholding to a majority stake in our Malaysian operation. Prudential is currently one of the top three life insurers in this sizeable market.

Prudential re-entered India through a majority shareholding in an asset management joint venture with ICICI, one of India's best known financial institutions. Three new mutual funds were launched successfully soon after the completion of the agreement. The joint venture is now one of the fastest-growing companies in India.

Across the region we have also been looking at extending its distribution capability. This includes pioneering the bancassurance channel in Indonesia with joint venture partner, Bank Bali. Furthermore an agreement was signed in December 1998 with Standard Chartered Bank to sell life insurance products to Standard Chartered's customers, initially in Singapore and Hong Kong.



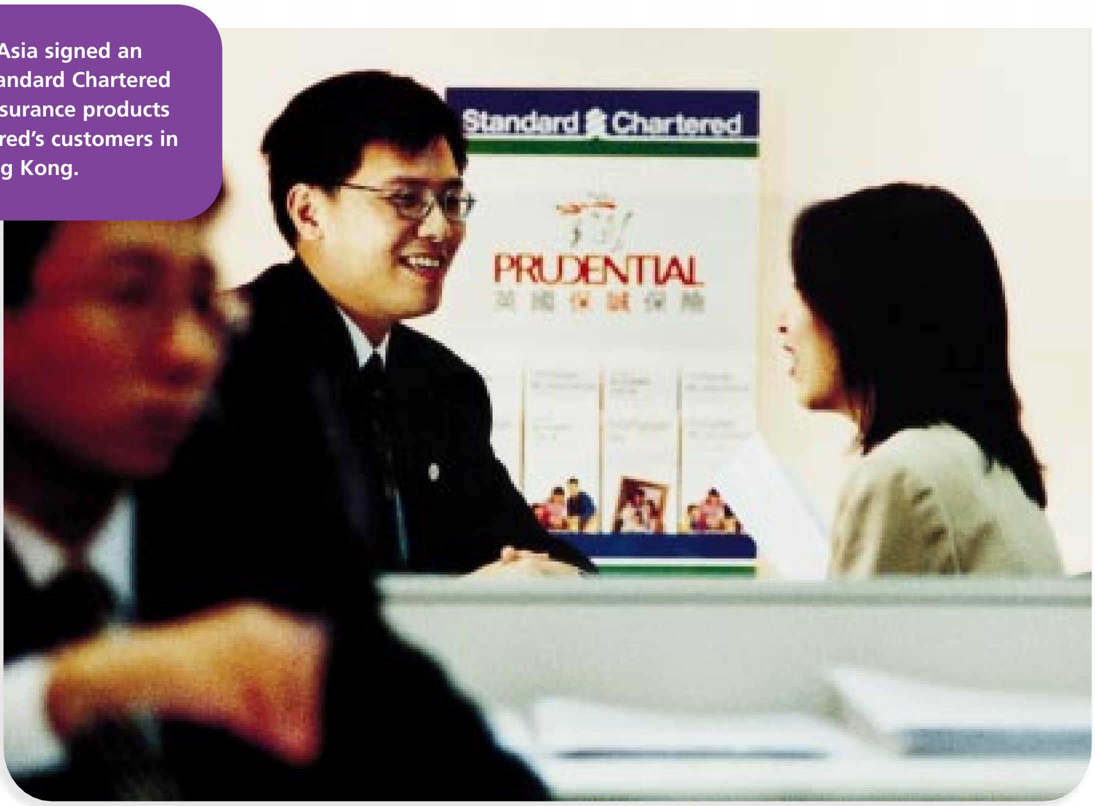

**Operating Profit Before Development Expenses (£m)**




**Weighted Premiums (£m)**

Undoubtedly the economic environment in Asia will continue to be challenging in the short-term, but we are nonetheless keen to seek out new opportunities which fit with our commitment to adding to shareholder value. As part of the business-building initiatives coming out of a major strategic review, we are assessing opportunities in North Asia, including Japan, South Korea and Taiwan.

**In 1998 Prudential Asia signed an agreement with Standard Chartered Bank to sell bancassurance products to Standard Chartered's customers in Singapore and Hong Kong.**



# UK

## Prudential Retail Financial Services

**"With one in six of the UK adult population as Prudential customers, we have an exceptional customer base which provides us with immense opportunities for expansion." John Elbourne, Chief Executive, Prudential Retail Financial Services.**


**Direct Salesforce Weighted New Business Premiums (£m)**


**Direct Sales Consultants (no.)**

Prudential Retail Financial Services comprises four business units: Prudential Retail (with its 3000-strong direct salesforce), Life and Pensions, Annuities and General Insurance.

In last year's Annual Report, we set out some of the challenges faced by our retail businesses. Not least amongst these was to ensure the highest level of compliance and to complete the first phase of the personal pensions review. On both of these major issues, excellent progress has been made: the overhaul of the compliance function has progressed to such an extent that we were able to recommence selective recruitment to the direct salesforce in December. We were also amongst the first companies to complete Phase I of the pensions review process and Phase II has started well.

1998 has seen major restructuring of Prudential Retail Financial Services. The appointment of new managing directors of Retail and of Life and Pensions as well as other changes in senior personnel are designed to set the foundation for strong performance in the new millennium. Our focus is on building long-term, profitable customer relationships by offering a high quality of advice and levels of service across a broad range of financial products.

Central to this reorientation has been a thorough review of the direct salesforce. The branch network has been streamlined to provide effective support for a smaller salesforce and we are now in the first stages of selective recruitment of financial consultants. As announced earlier this year, we moved away from commission-based remuneration for the salesforce, to a pay scheme which rewards quality of advice and high

**Jonathan Grant, voted Financial Adviser's Company Representative of the Year, meeting with his clients John and Barbara Parker.**

levels of customer service. The proposals, formulated in partnership with the National Union of Insurance Workers, were accepted in a ballot of the direct salesforce and will come into force in April 1999.

Underlying these changes is a commitment to providing the highest quality objective financial advice. Customer research shows that 80 per cent of our existing customers place a high value on face to face contact with our consultants. The relatively low level of general financial awareness, coupled with the increasing perceived need to make long-term financial provision, means that the need for financial advice is greater than ever before. It is our clear objective to be the leading provider of such a service.

Currently one in six of the UK adult population is a Prudential customer. That exceptional customer base provides us with immense opportunities for expansion through new products and new distribution channels which meet customers' individual needs in new ways. Substantial progress has been made towards turning the salesforce into an integrated marketing operation and we are making significant investment in new technology both to upgrade our customer databases and to enhance computer links to the salesforce.

## Sales and Profit

Weighted sales of long-term insurance products through Prudential's direct salesforce were unchanged in 1998 at £306 million. Weighted sales of investment products have fallen from £86 million to £23 million following the decision to withdraw from the regular premium PEP market.

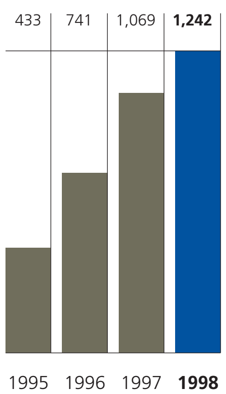
Profits of £333 million were three per cent ahead of 1997, with a corresponding increase in both the long-term and general insurance business.

# UK

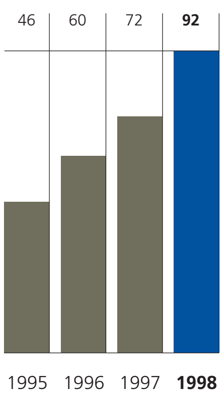
## Retail IFA Business

Scottish Amicable

**“Our strategy ensures that we provide the products and services that IFAs need and will ensure that we strengthen our market position.” Roy Nicolson, Chief Executive, Scottish Amicable.**




Retail IFA Sales of Single Premium Prudence Bond (£m)




Retail IFA Operating Profit (£m)

The Retail IFA business comprises the full range of life, pensions and investment products under the Scottish Amicable brand and Prudential Intermediary Division, producer of the market-leading Prudence Bond.

During 1998 the Retail IFA business contributed 41 per cent of Prudential’s total new business sales in the United Kingdom having increased weighted sales by 92 per cent over 1997. These encouraging results provide us with the platform for further growth in 1999. Operating profit for the year of £92 million was some 28 per cent ahead of prior year. This increase reflects both increased Prudence Bond volumes and a full year contribution from Scottish Amicable.

One of our key objectives for 1998 was to differentiate ourselves from our competitors by launching innovative products into the market whilst also developing our current products, with the major focus being on the Scottish Amicable brand. It was therefore encouraging that three of our products – Scottish Amicable’s Home Purchaser, Prudential’s Prudence Bond and Scottish Amicable European’s Long Term Care Bond – received top ratings in industry awards.

Our customer focus campaign also enjoyed success in the annual Financial Adviser service awards – voted for by our IFA customers. Scottish Amicable regained its five star award in the Life and Pensions category: an important milestone in the campaign to provide first class customer service. Prudential Intermediary Division and the IFA Service Centre were voted best providers by the Bradford and Bingley Building Society, their largest supporting IFA.

Furthering our commitment to Craigforth, plans have now been unveiled for a new office to house the additional 500 staff who will be needed to meet our ambitious targets.

Within Prudential Intermediary Division, IFA Direct has gone from strength to strength with responsibilities handed from the branches to the centre during the year. Our Reading staff, currently in six separate buildings, will be moved into a single location in the near future, which will further aid their efficiency.

During 1998 we have carried out in-depth research into the requirements of our IFA customers. Following detailed surveys through independent companies we are developing a revised customer service strategy covering the Craigforth operations. The key aim of this strategy will be to ensure that we retain our five star service rating and increase our overall levels of customer service.

Our research has shown strong support from IFAs for a choice of investment managers. We have therefore launched a new range of products which offer customers a number of fund management options. This choice will also be extended to our proposed ISA product.

In Scottish Amicable Life International we aim to increase our long-term core business in the UK and to increase our presence in the German IFA market by building on our considerable success in 1998 where we now have over a three per cent market share of unit linked business. We are also keen to expand into other European markets.

Overall this has been a highly successful year for the Retail IFA business. The challenge for 1999 is to build on that strength, expand our product range and distribution and improve still further our levels of customer service.

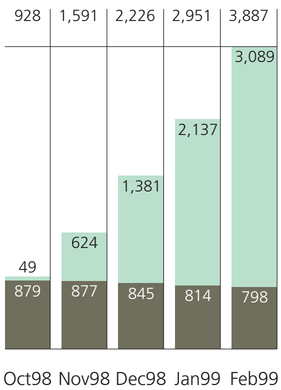
**Scottish Amicable's customer focus – building strong relationships with advisers – has played a key role in its success.**

# UK

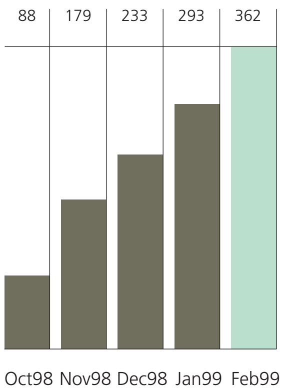
## Egg and Prudential Banking

egg: Individual Money Matters

**"In a fast-moving sector Egg will continue to harness technology in order to develop its range of products and services still further." Mike Harris, Chief Executive, Egg.**




Egg Deposits (£m)
Prudential Banking Deposits (£m)




Egg Internet Visits Since Launch (000)

Our new direct brand, Egg, was launched in October 1998, offering customers a range of market-leading deposit, mortgage and loan products by means of Internet and telephone. Prudential Banking products continue to be sold through the direct salesforce, targeted at a different market segment from those of Egg.

Egg's launch clearly captured the imagination of the UK public as a new way of dealing with their financial affairs. Our marketing and celebrity-led advertising campaigns produced a remarkable and initially overwhelming response: since launch, Egg has received over a million telephone calls, opened over 250,000 accounts and taken over £3 billion in deposits. The Egg brand is now widely recognised, receiving over 60 per cent customer recall.

The focus of Prudential Banking has been on mortgages, sales of which reached £466 million in 1998, more than double 1997 levels, while deposits stand at some £800 million. Prudential Banking continues to provide a natural facility for customers to bank funds from their maturing policies.

Egg is one of the first financial services brands to make comprehensive use of the Internet on a fully integrated basis. We are greatly encouraged by the number of enquiries and applications that have come through this route. This is an important development of Prudential's strategy of providing a broad range of products and services through a greater choice of distribution channels. The benefits of e-commerce are highly significant: access to valuable customers, lower costs and potentially higher cross-sales ratios. It is also a means of building relationships with large communities of customers and providing a foothold in this key market place of the future.

Henley Centre research concludes that by the year 2013 two out of every three financial products will be sold by electronic means. The United States is already providing us with evidence of the impact of e-commerce – last year consumers in the USA bought US$8 billion of goods through the Internet, a 300 per cent increase on the previous year. This major launch into the e-commerce market will prove an important growth opportunity for our future business. We have already significantly extended the Internet capability of Egg by giving customers the facility to check savings balances and transactions on-line.

As the technology revolution continues apace, Egg will broaden its range of products and explore new ways to exploit the Internet, personal computer technology, mobile devices and digital television, in order to complement more conventional telephone and direct mail facilities. Our new call centre in Derby is now operational and later this year employees will be transferred to the purpose-built Pride Park communications centre which has been designed to encourage positive relationships between Egg staff and their customers.

The success of Egg has meant that the overall investment in Egg and Prudential Banking is marginally up on the initial forecast at £77 million. It is likely that 1999's investment will rise to around £100 million with a small profit forecast for 2001.

**Egg's Internet site has proved enormously successful with over 350,000 visitors since launch whilst its call centres in Derby and Dudley handled over one million calls.**

# International

## Prudential Fund Management

"In the UK we have this year grouped together our investment-led business to accelerate growth." Derek Higgs, Chairman, PPM.

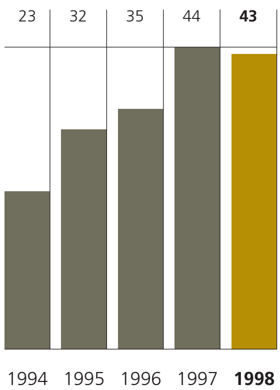
Prudential's fund management activities in the UK have been brought together under the chairmanship of Derek Higgs and a single management team. They comprise the corporate pensions business, collective investments including PEPs and unit trusts, and the fund management services of Prudential Portfolio Managers (PPM).

Operating profit for Prudential Fund Management totalled £50 million in 1998, in line with the previous year. Funds managed by PPM rose to £128 billion in 1998, up from £119 billion at the start of the year.

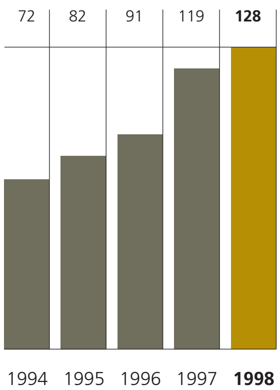
PPMWORLDWIDE

The Corporate Pensions business provides packaged investment and administration services to large employers. This business has some 3,500 clients, covering over 350,000 individuals with assets of around £4 billion. In the last year we have launched progressive initiatives with industry-wide groups to tackle issues raised by the government's stakeholder pension proposals.

Prudential Portfolio Managers manages funds worldwide for the Group. Its operations are based in four regional centres and seven investment offices world-wide, with centres being linked by a global investment network, ensuring consistent application of investment skill.



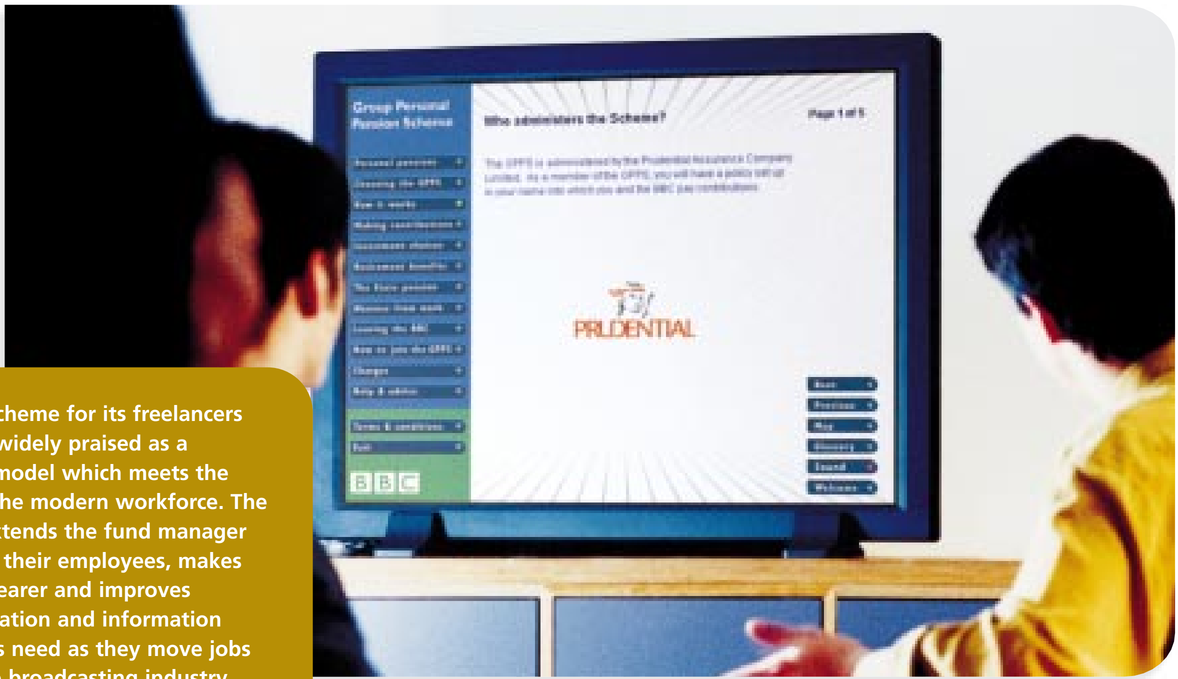

PPM Operating Profit (£m)




Funds Under Management (£bn)

### Investment Performance

Stretched valuations in major equity markets and the concentration of performance in only a small number of companies and sectors created difficult investment conditions for many active fund managers. PPM's research-intensive approach which concentrates on identifying companies with unrealised value, was not rewarded overall in 1998 although the areas of under-



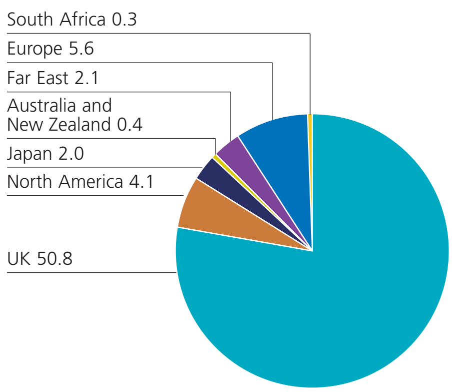

**The BBC scheme for its freelancers has been widely praised as a pensions model which meets the needs of the modern workforce. The scheme extends the fund manager choices to their employees, makes charges clearer and improves communication and information employees need as they move jobs within the broadcasting industry.**

performance were limited by the risk controls we have in place. Whilst a number of key funds have under-performed in 1998, the main £54 billion with-profits life fund continues to exceed competitors' performance over three and five year periods.

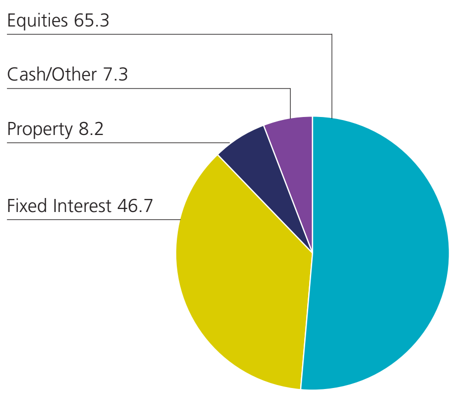
In Japan and the Far East, where funds managed by PPM won the 1998 best performance award from S&P/Micropal, our approach to investment proved successful. Our long-term approach and commitment to investment research was also recognised by the finance directors of the UK's top 350 companies who voted PPM Best Fund Manager in the 1998 Extel Survey of Investment Analysts.

In the area of new business, PPM had another successful year, winning over 50 new investment mandates with funds under management in excess of £1 billion. We continued to build our business, setting up an office in Tokyo, as well as strengthening our equity and bond investment teams.

As part of our investment portfolio, we manage properties valued at £8.2 billion, including numerous shopping centres, flagship office buildings, retail parks and industrial centres. Once again the property portfolio performed well in 1998, at least matching its competitors in this sector.




**Global Equity Holdings (£bn)**




**Types of Asset (£bn)**

# Group Financial Review

## Financial Summary

| | 1998 £m | 1997 £m |
|---|---|---|
| **Statutory basis operating profit** | | |
| Before tax (continuing operations) | **860** | 834* |
| After tax | **654** | 618* |
| Earnings per share | **33.7p** | 32.0p* |
| **Achieved profits basis operating profit** | | |
| Before tax (continuing operations) | **1,011** | 1,136* |
| After tax | **752** | 811* |
| Earnings per share | **38.7p** | 42.0p* |
| Dividend per share | **21.0p** | 19.1p |
| **Shareholders' funds** | | |
| Statutory basis | **3,249** | 2,783 |
| Achieved profits basis | **7,510** | 6,912 |

*Restated for change in accounting policies

## Modified Statutory Basis Results

Operating profit from continuing operations totalled £860 million in 1998, an increase of three per cent over prior year. The 1998 result includes an investment of £77 million in Egg and Prudential Banking; underlying growth before this investment is nine per cent.

The increase over 1997 reflects strong growth from Jackson National Life and our UK Retail IFA business. Jackson's result of £411 million is 12 per cent ahead of prior year due to asset growth and a small increase in margins. Jackson's after tax return on capital for the year of 18 per cent is ahead of our long-term target of 15 per cent. However, if the current low interest rate environment persists in the US, we would expect 1999's returns to be closer to this target. In the UK, the Retail IFA result of £92 million was 28 per cent up on 1997, due to continued growth in Prudence Bond volumes and a full year contribution from Scottish Amicable.

Elsewhere in the UK, Prudential Retail Financial Services and Prudential Fund Management's result of £333 million and £50 million respectively were both marginally ahead of the prior year. Prudential Retail Financial Services's result was impacted by lower reversionary bonus rates on conventional long-term business which offset the underlying volume growth. Given the prevailing low interest rates we would expect to see a continued downward trend for reversionary bonus levels. Within Prudential Fund Management's result of £50 million, the contribution from Prudential Portfolio Managers (PPM) is £43 million, in line with last year. Along with other fund managers, 1998 has been a challenging year and PPM have underperformed the benchmark for our key UK with-profits fund. This underperformance has adversely impacted 1998's result and is likely to impact next years' earnings.

The investment in Egg and Prudential Banking of £77 million is marginally ahead of the forecast at launch of £75 million. This increase reflects the success of the venture, which is already over halfway towards our original five-year target for deposits. Given this success we now estimate the loss for 1999 to be around £100 million, although a small profit is still expected in 2001 in line with our original expectations.

Total profit before tax for the year was £1,141 million. The principal reconciling item between operating profit from continuing operations of £860 million and total profit before tax is the gain on the disposal of our Australian and New Zealand operations, which was £249 million. A reconciliation between operating profit and profit before tax is included on page 43.

Operating profit earnings per share was up five per cent on prior year at 33.7 pence. This is ahead of the growth in operating profit due to the lower effective tax rate in 1998.

**Jonathan Bloomer,**
**Group Finance Director.**

## Supplementary Achieved Profits Basis Results

On the achieved profits basis of reporting, operating profit from continuing operations was £1,011 million in 1998, of which £955 million was contributed by continuing long-term business operations.

Profit from new long-term business held steady at £413 million. Within the UK's result of £220 million, a full year contribution from Scottish Amicable was offset by lower margins in our Prudential Retail Financial Services and Corporate Pensions business units due to a change in product mix and increased investment spend. Overseas Jackson's new business profit of £137 million was marginally down on prior year in line with lower sales volumes, while Asia's contribution of £56 million represents a very strong result given current adverse trading conditions.

Profit from long-term in force business of £542 million compare with £632 million in 1997. The 1998 result was held back by the shareholders' charge of £84 million for the increase in the provision for pensions mis-selling in the UK to £1.1 billion, and changes in economic assumptions reflecting lower anticipated returns in the Group's UK and US operations.

The calculation of the provision for pensions mis-selling in the UK is dependent upon a number of assumptions, particularly with regard to the Phase II element of the review and future interest rates; as a result, the provision could be susceptible to future revision.

The returns on average shareholders' funds for our long-term businesses based on local currency operating profit after tax, are shown in the table above:

| | **1998 per cent** | 1997 per cent |
|---|---|---|
| UK operations | **10** | 12 |
| Jackson National Life | **16** | 15 |
| Prudential Asia* | **18** | 25 |

*Established operations net of development costs

Total operating profit after tax on the achieved profits basis was £752 million and earnings per share were 38.7 pence.

A full description of the achieved profits methodology and the result for the year is included on pages 67 to 73.

## Accounting Policies

Consistent with the Statement of Recommended Practice on Accounting for Insurance Business published by the Association of British Insurers in December 1998, the method for recognition of investment return has been altered for the year ended 31 December 1998. Under the new method, investment returns credited to operating results, in respect of investments attributable to shareholders are, in most cases, determined using the longer-term rate of return whereas previously returns included investment gains averaged over five years. The effect of the change is shown in note 3 on page 55 and comparative results for 1997 have been restated on the new basis. This change has no effect on total profit before or after tax.

## Dividend

Given the progress made by the Company in 1998 and the confidence in the future success of the business, the Board has increased the total dividend for the year ten per cent to 21.0 pence per share. Dividend cover is 1.6 times based on statutory operating profit after tax.

# Group Financial Review

## Shareholders' Funds

The consolidated balance sheet on page 45 shows statutory basis shareholders' funds of £3,249 million at the end of 1998, an increase of £466 million from 1997. The increase primarily reflects the retained operating profit after dividend payments and the exceptional profit of £249 million arising on the disposal of the Group's Australasian businesses.

On the achieved profits basis, which recognises the shareholders' interest in our long-term businesses, shareholders' funds were £7,510 million compared with £6,912 million at the end of 1997. The increase reflects the operating profits retained in the long-term businesses, the profit on disposal of the Group's Australasian operations and strong UK investment returns, partly offset by the impact of changes in economic assumptions reflecting lower anticipated UK inflation rates.

The achieved profits basis provides a better indication of the Group's financial strength. It does not, however, anticipate the results of our discussions with the Treasury on the unattributed assets held in the main with-profits fund. For the purposes of the achieved profits basis results, it is assumed that only ten per cent of these assets are allocated to shareholders. The achieved profits basis shareholders' funds are analysed in the following table:

| | **1998 £m** | 1997 £m |
|---|---|---|
| UK operations | **3,957** | 3,750 |
| Jackson National Life | **2,149** | 1,846 |
| Prudential Asia | **378** | 260 |
| Other operations | **1,026** | 1,056 |
| Achieved profits basis shareholders' funds | **7,510** | 6,912 |

After adjusting for borrowings, approximately 75 per cent of these funds are held in sterling with a further 20 per cent held in US dollars.

## Funds Flow and Borrowings

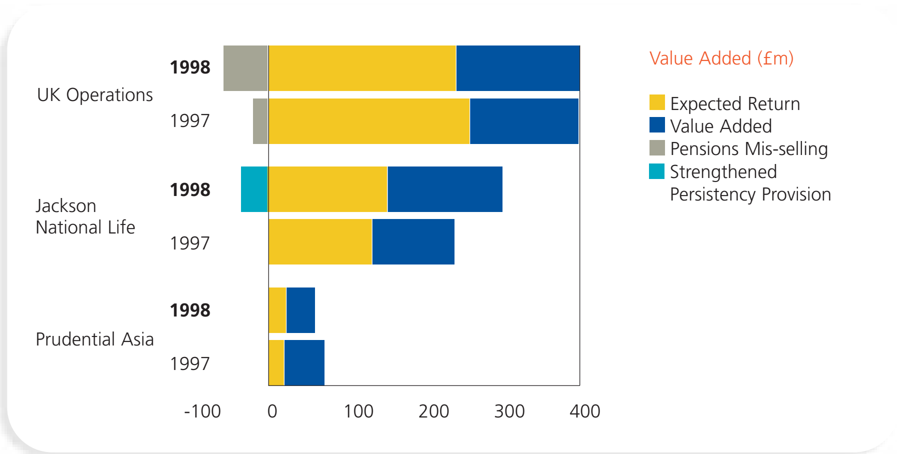
The table below provides details of the holding company's funds flow.

| | **1998 £m** | 1997 £m |
|---|---|---|
| Group operating profit after tax | **654** | 618* |
| Dividends | **(407)** | (370) |
| Reinvested in businesses | **(260)** | (224) |
| Funds available to holding company | **(13)** | 24 |
| New investment in businesses | **(265)** | (654) |
| Disposal of businesses | **481** | 47 |
| Timing differences and other items | **(160)** | 2* |
| Holding company net cash movement | **43** | (581) |

*Restated for change in accounting policies

We believe that for an insurance group this presentation provides a clearer demonstration of the utilisation of resources than the format prescribed under FRS1 shown on page 48. In 1998 the Group's operations generated funds after tax of £654 million, compared to £618 million in 1997, and retained profit after dividends was £247 million. We have reinvested £260 million in Jackson National Life and there was a further £265 million new investment in businesses, principally in Egg and Prudential Banking and in increasing our shareholding in our Malaysian business. The disposal of our Australasian operations resulted in sales proceeds of £481 million. Timing differences of £160 million include advance corporation tax payments that we expect to be repaid in 1999. Overall there was a net cash inflow in 1998 to the holding company of £43 million.

As a result of the above inflow, and exchange translation gains of £5 million, holding company cash less shareholders' borrowings at the end of 1998 totalled £453 million, compared with £405 million at the end of 1997.




Shareholders' funds included £1,826 million invested in cash and money market securities at the end of 1998, providing maximum liquidity and minimal capital risk.

Shareholders' borrowings at the end of 1998 totalled £1,373 million including £931 million at fixed rates of interest with maturity dates ranging from 2001 to 2027, as set out in note 20 on page 61. Half of these long-term borrowings were in US dollars, in order to partially hedge the currency exposure arising from our investment in Jackson National Life. There were also £442 million short-term commercial paper borrowings of which £235 million were in US dollars.

In January 1998 borrowings of SF200 million matured and in the same month the Group successfully launched a £300 million 25 year Eurobond issue at an interest rate of 6.875 per cent. The proceeds of the bond issue were used to redeem the SF bonds and to repay part of the Group's short-term borrowings.

Prudential Corporation enjoys strong debt ratings from both Moody's Investors Service and Standard and Poor's. Its rated long-term debt is Aa3 and AA+, whilst the short-term ratings of its guaranteed finance subsidiaries are P-1 and A-1+. The Group also retains access to both committed and uncommitted bank facilities.

## Treasury Policy

The Group operates a central treasury function, which has overall responsibility for managing its capital funding programme as well as its central cash and liquidity positions. The treasury function is also responsible for the co-ordination of risk management and investment policy across the Group.

To reduce investment, interest rate and currency exposures, and to facilitate efficient investment management, derivative instruments are used. Group policy is that amounts at risk through derivative transactions are covered by cash or by corresponding assets. The accounting treatment of derivative contracts is consistent with that of the underlying assets or liabilities.

The Group transacts business primarily in sterling and US dollars. The currency exposure relating to the translation of reported earnings is not separately managed although its impact is reduced by interest payments on the foreign currency borrowings and by the adoption of average exchange rates for the translation of foreign currency revenues.

## Financial Strength of Insurance Operations

The solvency ratio of free assets to liabilities within the Group's main UK long-term fund at the year end is estimated to be 22 per cent. The fund's financial strength continues to be rated Aaa by Moody's Investors Service.

The solvency position of Jackson National Life remains strong with a risk-based capital ratio of over 270 per cent of the regulatory minimum. In little more than a year Jackson's insurance financial strength rating has been upgraded by Moody's, A.M. Best and Duff & Phelps.

Despite difficult economic conditions in Asia, adequate solvency levels have been maintained by our insurance operations in that region.

Jonathan Bloomer
Group Finance Director

# Corporate Social Responsibility

Top: Young carers enjoying a break.
Bottom: Prudential supporting local educational initiatives in Hong Kong

Corporate social responsibility is more extensive than funding community projects: it embraces our response to issues such as the environment as well as the way we treat our employees, customers, shareholders and suppliers.

In 1998 a total of £1.8 million was invested in community support, arts and sports sponsorship programmes worldwide.

## Community Relations

In the UK support for carers continued with an emphasis on raising awareness of the needs of carers. 'Focus on Carers', an initiative to identify and support hidden carers with the assistance of GPs and Health Practitioners, was launched in partnership with the Princess Royal Trust for Carers in Scotland. In Northern Ireland a poster competition among schools was organised with Crossroads to highlight the role and needs of young carers.

The Prudential Carers' Awareness Fund made grants to a further twenty four carers' organisations for awareness-raising projects under the banner 'Action for Carers'.

Membership of Pru Youth Action Groups grew to around 30,000 in 1998. In partnership with Crime Concern, these young people are designing and implementing projects addressing issues such as personal safety, shop theft, drug and alcohol misuse and bullying. Following endorsement by the Home Office, as a result of the Crime and Disorder Act, there will be increased opportunities for young people to be actively involved in the design of local community safety partnerships through the Youth Action model of crime prevention.

Jackson National Life in the US supported diverse projects which benefit the Michigan and Chicago communities. These included sponsorship of the Michigan Festival, and the educational outreach programme of the Opera Company of Mid-Michigan, and direct funding for a range of educational and youth projects.

Prudential Asia continued a full programme to support the community, arts and sports. A range of sponsorships included Singapore's first heritage trail, a youth leadership camp in Hong Kong, a football tournament in Thailand, the Prudential Cup (cricket) in India and funding for several education projects in Vietnam. Staff in Indonesia collected money and clothing for the starving people of Irian Jaya.

Our commitment to equal opportunities continues through support for projects addressing discrimination by gender, race and disability and a pledge to help the young unemployed through the New Deal in the United Kingdom.

## The Arts

Prudential continues to provide the UK's biggest Arts prize with £200,000 going directly to the arts: Creative Britons, which replaced the Prudential Awards for the Arts, aims to identify creative people whose imaginations and vision have made a significant contribution to the cultural wealth of the country.

As part of the 150th Anniversary celebrations, we sponsored a new production of Cosi Fan Tutte at Glyndebourne and the opening season of the newly refurbished Sadlers Wells Theatre with performances by the Rambert Dance Company.

## The Environment

We recognise that our business activities, and the investments we make on behalf of our customers, have an effect on the environment. The directors regard concern for the environment and the management of environmental risks as an integral part of good business practice. The Group therefore endeavours to limit any adverse effects to the environment to a practical minimum.

## Investments

We expect companies in which we invest to be able to demonstrate and report on appropriate environmental policies especially when commercial activities have a significant impact. We are unlikely to hold shares in companies where we are not satisfied with the appropriateness of this environmental policy or ability to manage the risks associated with environmental impact.

We recognise that some commercial decisions by boards may not on occasions satisfy the aspirations of all those who focus exclusively upon environmental issues. However, we do believe that sensitivity to all interested parties, while reporting regularly to shareholders, will contribute towards a better understanding of the issues facing individual companies.

## Environmental Management

Progress has continued in the introduction of an environmental management system allocating responsibilities, processes and resources across all Prudential's businesses in the UK. We are establishing targets for progressive improvement in our environmental performance, focusing on waste minimisation, energy reduction and transport planning, which aims to cut unnecessary use of cars and fuel.

In our property business, we have adopted a policy statement containing specific guidelines for environmental management and are working with external professional bodies to develop green building designs. The award of Best New Centre to our shopping centre development in Bristol, The Mall at Cribbs Causeway, reflected its effective environmental management systems.

In 1998 we sponsored, for the first time, Prutour. Prutour is the UK's premier cycle race and fourth largest in the world. Prudential is also sponsoring Impruve (managed by the British Cycling Foundation) aimed at helping young people to develop cycling skills.

In 1998, Prudential participated for the second year in the annual Index of Corporate Environmental Engagement survey carried out by Business in the Environment. The index measures and compares the extent to which top UK companies are managing their environmental affairs. We believe that an external independent assessment provides a useful tool by which corporate environmental performance can be judged.

Prudential is a member of Forum for the Future's Green Futures Business Network and has continued support for HRH Prince of Wales' Business and the Environment Programme, which brings together senior executives from businesses, government and the community in the debate on sustainability.

Derek Higgs, Chairman of Prudential Portfolio Managers and a Director of the Group, is a member of the Government's Advisory Committee on Business and the Environment and has Board level responsibility for Prudential's environmental policy and its implementation.

# Board of Directors

*Non-executive director

**Sir Martin Jacomb***
**Chairman** (Age 69)
A director since 1994 and Chairman since 1995. Chairman of Delta plc. Director of Rio Tinto plc and Marks & Spencer plc.

**Michael Abrahams CBE DL***
**Deputy Chairman** (Age 61)
A director since 1984 and Deputy Chairman since 1991. Chairman of Prudential Staff Pensions, Kingston Communications (Hull) Plc, Minorplanet Systems, and the London Clinic. Director of John Waddington and Drummonds. Deputy Chairman of the Council of the Prince of Wales' Institute of Architecture.

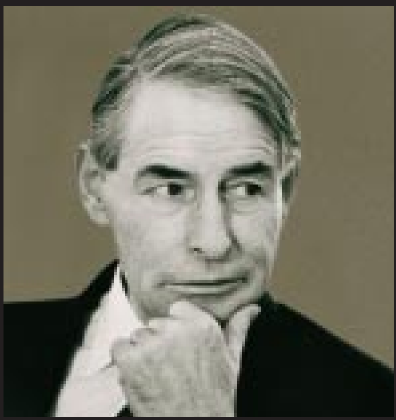
**Sir Peter Davis**
(Age 57)
Group Chief Executive since 1995 and a director since 1994. Director of Boots. Previously Chairman of Reed International. Chairman of New Deal Task Force and Business in the Community.

**Keith Bedell-Pearce**
(Age 53)
A director since 1992 and International Development Director since November 1996. Joined Prudential in 1972.

**Jonathan Bloomer FCA**
(Age 44)
Group Finance Director since 1995. Director of Railtrack Group plc. Member of the Urgent Issues Task Force Committee of the Accounting Standards Board. Previously a senior partner of Arthur Andersen.

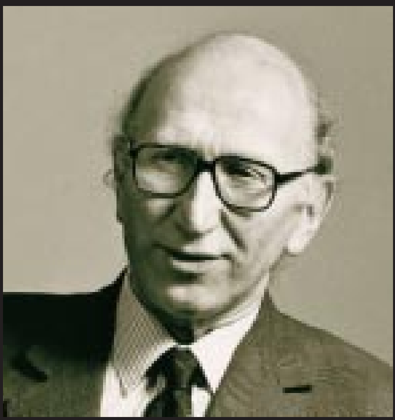
**Ann Burdus***
(Age 65)
A director since 1996. Director of Safeway and Next. Committee member of the Automobile Association and the Council of the Institute of Directors.

**Niall FitzGerald***
(Age 53)
A director since 1993. Chairman of Unilever and the Confederation of British Industry Europe Committee. Director of the Bank of Ireland.



**Lord Gillmore GCMG***
(Age 64)
A director since 1995. Vice Chairman of Vickers plc and Chairman of Board of Governors, Birkbeck College, University of London. Chairman of the Ditchley Foundation. Previously Permanent Under-Secretary of State and Head of HM Diplomatic Service.

**Derek Higgs**
(Age 54)
A director since 1996. Chairman of Prudential Portfolio Managers. Previously Chairman of S.G.Warburg & Co Ltd.



**Sandy Stewart***
(Age 65)
A director since October 1997. Chairman of Murray Extra Return Investment Trust plc. Previously Chairman of Scottish Amicable Life Assurance Society.

**Sir David Barnes CBE***
(Age 62)
A director since 4 January 1999. Chief Executive of Zeneca PLC.

# Corporate Governance

The directors support the Combined Code. With the exception of directors' re-election and directors' contract periods where, as explained on pages 31 and 33 respectively action will be taken during 1999, the Company has complied throughout the accounting period with all the Code provisions. We have applied the principles in the manner described below and, in the Remuneration report.

## Organisational Structure

The organisational structure of the Group is clearly defined with lines of responsibility and delegation of authority. The Board, the members of which are set out on pages 28 and 29, meets regularly, usually monthly, and decides the objectives and strategy and has set out the specific matters which are reserved to it for decision.

Authority is delegated to the group chief executive for implementing the strategy and for managing the Group. In discharging his responsibility, the group chief executive works with a group executive committee, comprising all the executive directors and other business unit heads, and is also assisted by a group head office team of functional specialists.

The head of each business unit has authority for management of that business unit and has established a management board comprising the most senior executives in that business unit.

All directors have direct access to the advice and services of the company secretary who is responsible to the Board for ensuring that Board procedures are followed and that applicable rules and regulations are complied with. Full Board papers are provided to all directors approximately one week before each Board or committee meeting.

## Board Committees

The Board has established the following committees of non-executive directors to which it has delegated certain of its responsibilities:

*Audit Committee*

Michael Abrahams (Chairman)
Ann Burdus
Lord Gillmore

The Audit Committee normally meets six times a year and assists the Board in meeting its responsibilities in ensuring an effective system of internal control and accurate external financial reporting. It also provides a direct channel of communication between the external auditors and the Board and assists the Board in ensuring that the external audit is conducted in a thorough, objective and cost-effective manner.

The group chief executive, the group finance director, the group internal auditor, the group legal services director and the external auditors attend all meetings of the Committee except when the Committee wishes to meet alone.

*Remuneration Committee*

Niall FitzGerald (Chairman)
Michael Abrahams
Ann Burdus
Lord Gillmore
Sandy Stewart

The Remuneration Committee normally meets three times a year to review remuneration policy and determines the remuneration packages of the executive directors. In framing its remuneration policy, the Committee has given full consideration to the provisions of Section 1B of and Schedule A to the Code. The remuneration report prepared by the Board is set out on pages 33 to 38. In preparing the report, the Board has followed the provisions of Schedule B to the Code.

The Remuneration Committee consults the chairman and, when appropriate, the group chief executive about the Committee's proposals relating to the remuneration of the other executive directors and has access to professional advice inside and outside the Company.

*Nomination Committee*

Sir Martin Jacomb (Chairman)
Michael Abrahams
Ann Burdus
Sandy Stewart

The Nomination Committee meets as required to consider candidates for appointment to the Board.

## Independent Professional Advice

The Board has approved a procedure whereby directors have the right in furtherance of their duties to seek professional advice at the Company's expense.

Copies of any instructions and advice given by an independent professional adviser to a director is supplied by the director to the company secretary who will, unless otherwise instructed by the director concerned, circulate to other directors any necessary information to ensure that other members of the Board are kept informed on issues arising affecting the Company or any of its subsidiaries.

No director obtained independent professional advice during 1998.

## Directors' Independence, Training and Re-election

All non-executive directors are considered to be independent. After the chairman, the deputy chairman, Michael Abrahams, is recognised as the senior independent director. As the UK's largest institutional investor, conflicts of interest are always possible, but the Board does not consider that this affects the independence of those non-executive directors in whose companies the Company has a shareholding.

Non-executive directors are appointed initially for a three year term. The appointment is then reviewed towards the end of this period. All non-executive directors, upon appointment, embark upon a programme of induction that will usually take the form of visits to different business areas in the Group where the opportunity is taken for the newly appointed director to meet members of staff. Training is available for executive directors where appropriate.

It is the Company's practice to require all directors to submit themselves for re-election at regular intervals and at least every three years. A resolution will be proposed at this year's Annual General Meeting amending the Company's Articles of Association to formalise this.

## Relations with Shareholders

As a major institutional investor, the Company is acutely aware of the importance of maintaining good relations with its own institutional investors. The Company regularly holds discussions with major shareholders and a programme of meetings took place during 1998.

The Company believes the Annual General Meeting is an important forum for both institutional and private shareholders and encourages attendance by shareholders. At its Annual General Meeting in 1998 the Company indicated the level of proxies lodged on each resolution and the balance for and against the resolution after it had been dealt with on a show of hands. The Company proposes to continue with this practice at this year's Annual General Meeting. The Notice of the Annual General Meeting and related papers are sent to shareholders at the same time as the Annual Report. As with last year's Annual General Meeting, a business presentation will be provided and questions sought from shareholders.

## Financial Reporting

The directors have a duty to report to shareholders on the performance and financial position of the Group and are responsible for preparing the financial statements on pages 41 to 63 and the supplementary information on pages 67 to 73. It is the responsibility of the auditors to form an independent opinion, based on their audit, on those financial statements and to report their opinions to the Company's shareholders. These opinions are given on pages 64 and 74.

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and of the Group and of the result of the Group for the period and which comply with the Companies Act 1985. In preparing those statements, the directors ensure that suitable accounting policies are selected and applied consistently, that reasonable and prudent judgements and estimates are made and that applicable accounting standards are followed. They also ensure that appropriate accounting records are maintained for the preparation of those statements and that reasonable steps are taken to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

# Corporate Governance

After making appropriate enquiries, the directors consider that the Group has adequate resources to continue in operational existence for the foreseeable future. They therefore continue to use the going concern basis in preparing the financial statements.

## Internal Control

The management of exposure to risk is fundamental to the Group's operations which mainly involve the acceptance of investment and underwriting risks. The Group's system of internal control, for which the Board has overall responsibility, is an essential and integral part of the risk management process and the main features are as follows:

### *Investment*

The respective responsibilities of the Board and business unit management for investment strategy, compliance and performance are clearly defined. There are also detailed rules governing investment dealing and settlement, including the use of derivatives, incorporating details of procedures and authority levels.

### *Underwriting*

The Group has controls over underwriting exposures covering both risks accepted and reinsured. Exposure limits are reviewed annually.

### *Financial Control Procedures*

Detailed controls, applicable across the Group, are laid down in financial and actuarial procedures manuals.

### *Performance Planning and Monitoring*

There is a comprehensive planning and performance monitoring system based on key performance indicators for each business area. The Group is currently introducing value-based management in its operations, starting with the UK businesses.

### *Financial Position*

The Board receives regular reports from the group finance director on financial matters and receives annual reports from the group chief actuary on the financial condition of the Group's principal long-term insurance businesses.

### *Compliance*

The head of the group compliance function monitors adherence to regulatory requirements and reports directly to the Audit Committee on both UK and non-UK compliance matters.

### *Audit*

The head of the group internal audit function has direct access to the chairman of the Audit Committee and any significant matters arising from internal audit work are reported to the Committee. The Audit Committee receives twice-yearly reports from the external auditors on internal financial control and reviews action taken in response to any weaknesses which are identified.

### *Effectiveness of Internal Financial Control*

Following the concession granted by the London Stock Exchange on 10 December 1998 in relation to Code provision D.2.1 on Internal Controls, the Board has reviewed the effectiveness of the system of internal financial control in operation during the year through the monitoring processes set out above and pursuant to the guidance that was issued by the Rutteman Working Group in December 1994.

In addition, during the year each business area, including group head office, prepared an assessment of its risk exposures and internal financial control framework. This work was reviewed by the external auditors and a summary of the findings was considered by the Audit Committee. Such processes can provide only reasonable and not absolute assurance against material errors, misstatements or loss and, in that context, the review did not reveal any significant matters which, in the opinion of the Board, indicated that the system of internal financial control was inappropriate or unsatisfactory.

# Remuneration Report

The Remuneration Committee of the Board during 1998 comprised Niall FitzGerald (Chairman), Michael Abrahams, Ann Burdus, Lord Gillmore and Sandy Stewart (and Andrew Teare as Chairman until the date of his retirement). The Committee is responsible for setting remuneration policy and individual remuneration packages for executive directors. In framing its policy, the Committee has given full consideration to the provisions of Schedule A to the Combined Code.

## Executive Directors' Remuneration

### *Remuneration Policy*

The policy of the Company is to provide competitive remuneration packages in order to recruit and retain high calibre executives. In addition to salary and pensions, this is achieved by means of an annual bonus and a long-term incentive plan directly related to the Company's longer-term performance. The Executive Share Option Scheme terminated in 1995.

### *Salary*

Executive directors' salaries are reviewed by the Remuneration Committee, normally annually, having regard to business results, individual accountabilities and performance, and market conditions. Independent surveys are obtained on salary levels in major companies of comparable size in both the financial and non-financial sectors.

### *Annual Bonus*

This element of the directors' remuneration package is designed to encourage directors to achieve the highest levels of annual corporate performance.

During 1998, executive directors other than Derek Higgs qualified for awards under the Group's short-term deferred bonus plan, known as the Share Participation Plan. Awards were determined by the Remuneration Committee based on the performance of the Group against quantitative financial and business targets, as well as specific personal objectives, up to a maximum total award value of 45 per cent of salary at the time of the award.

Under the Plan executive directors received an initial cash award. Either the net amount of this award had to be used to buy shares or an equivalent number of shares had to be lodged with the Trustees of the Plan. The Company then lodged additional shares with the Trustees equivalent to the gross value of the cash award. Both sets of shares are held in trust for five years. If a director leaves prior to this, the additional shares may be released in certain circumstances.

During 1998, Derek Higgs was eligible to be awarded a bonus, up to a maximum of 100 per cent of salary at the time of the award. Half of the net amount of the bonus was used to buy Prudential shares. The bonus was based on the overall performance of Prudential Portfolio Managers, his performance as an executive director of the Company and performance against personal objectives.

For 1999, both the above arrangements will be replaced by a new short-term incentive plan in which awards will be made in cash with no deferral period. These awards will continue to be based on the performance of the Group against quantitative financial and business targets, and to take account of an element of personal performance. The maximum awards under this plan will remain as at present. Awards under this plan will not be pensionable.

### *Benefits*

Executive directors receive certain taxable benefits, principally the provision of company cars. These benefits are not pensionable.

### *Service Contracts*

In 1995 the Remuneration Committee changed its policy so that the normal notice of termination which the Company is required to give executive directors is 12 months, although for newly appointed directors there may be an initial contractual period of up to two years before the 12-month notice period applies. In the case of Keith Bedell-Pearce, who was in office prior to 1995 and of Jonathan Bloomer who joined the Company in 1995, the period was previously reduced to 18 months from three years. During 1999, this period will be further reduced to 12 months. When considering termination of service contracts, the Committee will have regard to the specific circumstances of each case, including mitigation.

### *Policy on External Appointments*

Executive directors are able, subject to the Board's approval, to accept a limited number of external appointments as non-executive directors of other organisations.

# Remuneration Report

## Non-executive Directors' Remuneration

The fees for non-executive directors are reviewed annually by the Board after considering recommendations by the executive directors. Since 1 June 1996, non-executive directors' fees have been £25,000 per annum and £45,000 per annum for the deputy chairman. The chairman's fee was increased to £175,000 per annum from 1 June 1997. In addition, Sandy Stewart as chairman of the supervisory board of the Scottish Amicable Insurance Fund and Michael Abrahams as a non-executive director of Scottish Amicable Life plc receive fees of £25,000 and £20,000 per annum, respectively. Non-executive directors do not have service contracts and are not eligible for the annual bonus, the long-term incentive scheme or pensions, except that the one director appointed prior to 1988, Michael Abrahams, remains a member of the Prudential Staff Pension Scheme.

| Directors' Remuneration | Salary /Fees £000 | Annual Bonus £000 | Benefits £000 | Total 1998 £000 | Total 1997 £000 |
|---|---|---|---|---|---|
| **Executive directors** | | | | | |
| Keith Bedell-Pearce | 275 | 75 | 27 | 377 | 336 |
| Jonathan Bloomer | 347 | 99 | 30 | 476 | 457 |
| Sir Peter Davis | 513 | 148 | 28 | 689 | 655 |
| Derek Higgs | 347 | 172 | 19 | 538 | 486 |
| Jim Sutcliffe (resigned 30/9/97) (note 2) | | | | | 359 |
| **Total executive directors** | 1,482 | 494 | 104 | 2,080 | 2,293 |
| **Non-executive directors** | | | | | |
| Michael Abrahams | 65 | | | 65 | 50 |
| Ann Burdus | 25 | | | 25 | 25 |
| Niall FitzGerald (note 3) | 25 | | | 25 | 25 |
| Lord Gillmore | 25 | | | 25 | 25 |
| Sir Martin Jacomb | 175 | | 12 | 187 | 186 |
| Sandy Stewart (appointed 9/10/97) | 50 | | | 50 | 12 |
| Andrew Teare (retired 7/5/98) | 9 | | | 9 | 25 |
| **Total non-executive directors** | 374 | | 12 | 386 | 348 |
| **Overall total** | 1,856 | 494 | 116 | 2,466 | |
| Overall total 1997 | 1,884 | 599 | 158 | | 2,641 |

Notes:

1. The highest paid director was Sir Peter Davis whose emoluments, including the value of shares allocated to him (but not released until April 2000) under the long-term incentive plan, were £1,501,000. Additionally, the Company made pension contributions of £204,000 on his behalf. This amount comprised contributions of £182,000 to a Funded Unapproved Retirement Benefit Scheme and £22,000 to the Prudential Staff Pension Scheme and a separate life assurance scheme. Last year the highest paid director was Jim Sutcliffe whose emoluments, including gains of £539,000 on share options exercised and the value of £98,000 of shares allocated to him under the long-term incentive plan, were £996,000. His accrued pension entitlement at the date he ceased to be a director was £101,000.
2. In 1997, Jim Sutcliffe received compensation for loss of office, including the value of benefits, totalling £343,000 plus pension service credit up to the date he commenced alternative employment.
3. Fees in respect of Niall FitzGerald are paid to his employer.
4. The annual bonus reflects the total award under the Share Participation Plan, including the cost of the shares lodged by the Company with the Plan Trustees.

## Directors' Long-term Incentive Plan

The Group's long-term incentive plan is known as the Restricted Share Plan and is designed to provide reward contingent upon the achievement of pre-determined returns to shareholders, thereby aligning directors' interests with those of shareholders and encouraging them to perform at the highest level. Under this Plan executive directors are granted annually a conditional award of shares in the Company which is held in trust for three years. The conditional award is equivalent to 80 per cent (or 100 per cent in the case of the group chief executive) of salary at the time of the award, valuing the shares at their average share price during the preceding calendar year.

The number of shares that the directors are allocated out of the conditional award after three years depends on the Company's total return to shareholders relative to other companies in the FTSE 100 share index over the three years. In addition, the Remuneration Committee must be satisfied with the Company's overall financial performance during this period. No shares will be allocated if the Company's total return ranks 60th or below and the maximum allocation will be awarded only if the total shareholder return is in the top 20. Between these points, allocations of shares will be on a straight line basis. The right to receive allocations may then be exercised by the director concerned at any time during the following seven years.

Details of conditional awards of shares under the Plan are shown below. These shares are held in trust and represent the conditional awards out of which allocations may be made, as stated above, in the allocation year.

In respect of the 1996 Restricted Share Plan, the Company's total return to shareholders was ranked 13th out of the 98 relevant comparator companies for the three year performance period ended on 31 December 1998. As a result, options will be granted over 100 per cent of the shares conditionally awarded to executive directors.

| | Conditional awards outstanding at 1 Jan 1998 | Conditionally awarded in 1998 | Awards allocated in 1998 | Conditional awards outstanding at 31 Dec 1998 | Release year |
|---|---|---|---|---|---|
| Keith Bedell-Pearce | 48,037 | | | 48,037 | 1999 |
| | 39,350 | | | 39,350 | 2000 |
| | | 36,024 | | 36,024 | 2001 |
| | 87,387 | 36,024 | | 123,411 | |
| Jonathan Bloomer | 63,511 | | | 63,511 | 1999 |
| | 56,859 | | | 56,859 | 2000 |
| | | 45,390 | | 45,390 | 2001 |
| | 120,370 | 45,390 | | 165,760 | |
| Sir Peter Davis | 90,226 | | 90,226* | | 2000 |
| | 115,474 | | | 115,474 | 1999 |
| | 101,534 | | | 101,534 | 2000 |
| | | 79,417 | | 79,417 | 2001 |
| | 307,234 | 79,417 | 90,226* | 296,425 | |
| Derek Higgs | 69,285 | | | 69,285 | 1999 |
| | 56,859 | | | 56,859 | 2000 |
| | | 45,390 | | 45,390 | 2001 |
| | 126,144 | 45,390 | | 171,534 | |

*These shares are in respect of the 1995 Restricted Share Plan, with a three year performance period ended on 31 December 1997. They are, however, held in trust for a further two years after allocation and will not be released until April 2000. These shares are included within the directors' shareholdings in the table on page 36. The market value of the award, based on the market price of the shares on the day of the allocation was £812,000. No awards were allocated to any of the above directors in 1997.

# Remuneration Report

## Directors' Shareholdings

The interests of directors in shares of the Company, including awards under the Share Participation Plan and allocated under the Restricted Share Plan, but excluding conditional awards under the Restricted Share Plan, are shown below. All interests are beneficial except in respect of 7,200 shares held in trust by Sandy Stewart.

| | 1 Jan 1998 | 31 Dec 1998 |
|---|---|---|
| Michael Abrahams | 12,894 | 12,894 |
| Keith Bedell-Pearce | 81,784 | 80,808 |
| Jonathan Bloomer | 36,125 | 45,628 |
| Ann Burdus | 2,552 | 2,552 |
| Sir Peter Davis | 58,746 | 160,852 |
| Niall FitzGerald | 3,709 | 3,709 |
| Lord Gillmore | 2,686 | 2,686 |
| Derek Higgs | 36,439 | 41,344 |
| Sir Martin Jacomb | 17,498 | 17,955 |
| Sandy Stewart | 9,700 | 9,700 |

Sir David Barnes held 3,750 shares on the date of his appointment as a non-executive director, on 4 January 1999. There were no changes in interests between 31 December 1998 and 26 February 1999.

## Directors' Share Options

The Restricted Share Plan replaced the Executive Share Option Scheme in 1995 as the Group's long-term incentive plan. Outstanding options under that Scheme remain in force and are set out below together with options under the Savings-Related Share Option Scheme. This Scheme is open to all employees and options up to Inland Revenue limits are granted at a 20 per cent discount and cannot normally be exercised until a minimum of three years has elapsed.

| | Options outstanding at 1 Jan 1998 | Exercised in year | Options outstanding at 31 Dec 1998 | Exercise price (pence) | Market price at date of exercise (pence) | Gains on exercise £000s | Earliest exercise date | Latest exercise date |
|---|---|---|---|---|---|---|---|---|
| Keith Bedell-Pearce | 189,000 | | 189,000 | 201 | | | 1995 | 2002 |
| | 105,000 | | 105,000 | 328 | | | 1996 | 2003 |
| | 5,769 | 5,769* | | 156 | 936 | 45 | | |
| | 60,500 | | 60,500 | 309 | | | 1997 | 2004 |
| | 6,716 | | 6,716* | 201 | | | 1998 | 1999 |
| | 2,267 | | 2,267* | 344 | | | 2003 | 2004 |
| | 3,259 | | 3,259* | 359 | | | 2003 | 2004 |
| | 372,511 | 5,769 | 366,742 | | | 45 | | |
| Jonathan Bloomer | 226,750 | 30,000 | 196,750 | 315 | 819 | 151 | 1998 | 2005 |
| | 226,750 | | 226,750 | 315 | | | 2000 | 2005 |
| | 7,677 | | 7,677* | 254 | | | 2002 | 2002 |
| | 461,177 | 30,000 | 431,177 | | | 151 | | |
| Sir Peter Davis | 5,014 | | 5,014* | 344 | | | 2001 | 2001 |
| Derek Higgs | 5,014 | | 5,014* | 344 | | | 2001 | 2001 |
| Total | | | | | | 196 | | |

*Savings-Related Share Option Scheme

None of the above directors exercised any share options in 1997. The market price of shares at 31 December 1998 was 907.5 pence and the range during 1998 was from 638 pence to 959.5 pence.

## Directors' Pensions

*Prudential Staff Pension Scheme*

Executive directors are eligible to participate in the Prudential Staff Pension Scheme on the same basis as other members. The Scheme is non-contributory and provides members with a maximum pension of up to 38/60 of Final Pensionable Earnings at the normal retirement age of 60. Final Pensionable Earnings are the sum of the pensionable salary for the 12 months immediately preceding retirement or termination of employment and for entrants since 31 May 1989, are restricted to salary up to the Inland Revenue earnings cap.

The Scheme also provides on death, whether in service or following retirement, pensions for spouse and children. The spouse's pension on death in service is 54 per cent of the member's prospective pension at age 60 and, on death after retirement, is 50 per cent of the member's pension in payment. A lump sum death in service benefit of four times Final Pensionable Earnings is also provided. Pension increases after retirement are wholly discretionary but in recent years annual increases have been awarded in line with inflation. Discretionary increases are taken into account in calculating transfer values payable in lieu of deferred pension benefits. The contract of Keith Bedell-Pearce provides that in the event of his retirement at age 55, his pension will be based on the pension he would have received at normal retirement age 60 subject to a discount rate of three per cent per annum for early retirement.

*Other Pension Arrangements*

For directors subject to the earnings cap, the Company has established Funded Unapproved Retirement Benefit Schemes (FURBS) and a separate life assurance scheme to provide additional retirement and life assurance benefits based on salary in excess of the earnings cap. Both Sir Peter Davis and Derek Higgs participate in these arrangements. Jonathan Bloomer does not participate in the FURBS and instead the Company pays a salary supplement to fund personal pension arrangements. He does however participate in the separate life assurance scheme and additionally the Prudential Staff Pension Scheme provides a lump sum death in service benefit.

# Remuneration Report

## Directors' Pensions continued

*Pension Entitlements*

Details of directors' pension entitlements under the Prudential Staff Pension Scheme and pre-tax contributions to FURBS or salary supplements are set out below.

| | Age at 31 Dec 1998 | Years of pensionable service at 31 Dec 1998 | Additional pension earned (excluding inflation) in year £000 | Accrued entitlement based on normal retirement age 31 Dec 1998 £000 | Accrued entitlement based on normal retirement age 31 Dec 1997 £000 | Pre-tax contribution to FURBS or salary supplement 1998 £000 | Pre-tax contribution to FURBS or salary supplement 1997 £000 |
|---|---|---|---|---|---|---|---|
| Keith Bedell-Pearce | 52 | 28 | 13 | 139 | 122 | | |
| Jonathan Bloomer | 44 | | | | | 90 | 82 |
| Sir Peter Davis | 57 | 3 | 1 | 5 | 4 | 182 | 171 |
| Derek Higgs | 54 | 2 | 1 | 4 | 3 | 105 | 98 |
| Michael Abrahams (note 1) | 61 | 14 | 1 | 9 | 8 | | |
| Total | | | | | | 377 | 351 |

Notes:

1. For the one remaining non-executive director appointed before 1988, Michael Abrahams, the normal retirement age in the Scheme is 72 but a pension not discounted for early retirement is available from age 65. The spouse's pension on death in service is 50 per cent of the member's prospective pension at age 72 and, on death after retirement, 50 per cent of the member's pension in payment. No lump sum benefit is payable on death in service.
2. Total contributions to directors' pension schemes were £462,000 (1997 £441,000).

## Service Contracts of Directors Proposed for Re-election

The unexpired terms of the service contracts of Jonathan Bloomer and Derek Higgs, who are proposed for re-election at the forthcoming annual general meeting, are 12 months. Sir David Barnes, who is proposed for election, and Michael Abrahams, who is proposed for re-election, do not have service contracts.

On behalf of the Board of Directors

Niall FitzGerald
Chairman of the Remuneration Committee
18 March 1999

# Directors' Report

## Principal Activity and Business Review

Prudential Corporation plc is the Group holding company and the principal activity of its subsidiary undertakings is the provision of financial services in the United Kingdom and overseas. Particulars of principal subsidiary undertakings are given on page 62. The Group's business is reviewed in the Chairman's Statement on pages 4 and 5 and the Group Chief Executive's Review on pages 6 to 9.

## Financial Statements and Supplementary Information

The consolidated balance sheet on pages 44 and 45 shows the state of affairs of the Group at 31 December 1998. The Company's balance sheet appears on page 47 and the consolidated profit and loss account on pages 41 to 43. There is a five year review of the Group on pages 65 and 66. Supplementary information prepared on the achieved profits basis of financial reporting is provided on pages 67 to 73.

## Dividends

The directors have declared a final dividend for 1998 of 14.0 pence per share payable on 26 May 1999 to shareholders on the register at the close of business on 26 March 1999. The dividend for the year, including the interim dividend of 7.0 pence per share paid in 1998, amounts to 21.0 pence per share compared with 19.1 pence per share for 1997. The total cost of dividends for 1998 was £407 million.

## Millennium

The Millennium issue is the potential problem arising from computer software developed to recognise only two digits rather than four and, if not corrected, being unable to distinguish the year 2000 from the year 1900. We have taken the issue very seriously for some time and have established eight separate Millennium programmes across the Group to identify and address the risks associated with the Millennium, to ensure all areas of the business will be compliant in good time and that they have contingency plans in place to ensure business continuity.

A central monitoring function has been established at Group Head Office level, which reports to the Group Executive Committee. External consultants have been hired to verify independently that the detailed and thorough testing procedures we have put into place have been completed successfully and on schedule.

With a few manageable exceptions, critical internal IT systems were assessed, fixed and tested by the end of 1998. All of the remaining systems are due to be completed by the end of quarter two 1999.

Business contingency plans are scheduled to be in place and tested by the end of quarter three 1999.

Key suppliers in all locations are being approached to ascertain status information on their Millennium initiatives. Suppliers of all types of products and services are being closely monitored and if, in our opinion, they have not adequately prepared for the Millennium, we are actively searching for replacement suppliers. New suppliers have to be able to demonstrate their compliance with Millennium standards, or at least show comprehensive plans on how they are addressing the situation.

It is difficult to separate discrete Millennium expenditure from the Group's general systems enhancements and development spend. However, it is estimated the Group's total incremental cost relating solely to Millennium will be in the range of £150 million to £175 million.

## Payment Policy

The Group does not follow any code or standard on payment practice with its suppliers but it is the policy of the Group to agree terms of payment when orders for goods and services are placed and to pay in accordance with those terms. Trade creditor days, based on the ratio of trade creditors at the year end to the amounts invoiced by trade creditors during the year, were 27 days.

## Directors

The present directors are shown on pages 28 and 29. Sir David Barnes was appointed a director on 4 January 1999 and in accordance with the Articles of Association retires and offers himself for election at the Annual General Meeting. Michael Abrahams, Jonathan Bloomer and Derek Higgs retire by rotation at the Annual General Meeting and offer themselves for re-election. Niall FitzGerald also retires by rotation but does not offer himself for re-election. Details of directors' interests in the share capital of the Company are set out in the Remuneration Report on page 36.

# Directors' Report

## Employees
The following information is given in respect of employees of the Group in the United Kingdom. The policy towards employees overseas is the same but the practical application of the policy varies according to local requirements.

## Equal Opportunity
Our equal opportunities policy is to be fair, responsible and caring in all aspects of our business. We recognise, respect and value difference and diversity. We will treat everyone fairly and with dignity. We are working towards equality as a part of our normal way of doing things because we believe it is the right thing to do for our people, our customers and our success.

Full consideration is given to continuing the employment of staff who become disabled and to providing training and career development opportunities to disabled employees.

## Employee Involvement
The Group has effective communication channels through which employees' views can be sought on issues which concern them. In 1998 employees were invited to participate in the Prudential Savings-Related Share Option Scheme. The Scheme has now been operating for over 14 years and some 70 per cent of UK staff currently participate.

The board of the corporate trustee of the Prudential Staff Pension Scheme includes directors elected by members of the Scheme, who have approved the continuation of this arrangement under the Pensions Act 1995.

## Donations
Charitable donations made by the Group in 1998 totalled £1.8 million.

There were no political donations.

## Auditors
The Company's auditors, Price Waterhouse, merged with Coopers & Lybrand on 1 July 1998, creating a new firm called PricewaterhouseCoopers. Price Waterhouse resigned as auditors of the Company on 29 July 1998 and PricewaterhouseCoopers were appointed by the directors on 29 July 1998 to fill the casual vacancy that arose.

A resolution proposing the re-appointment of PricewaterhouseCoopers as auditors of the Company will be put to the Annual General Meeting.

## Shareholders
The number of accounts on the share register at 31 December 1998 was 80,205 (78,727). Further information about shareholdings in the Company is given on page 75. At 26 February 1999 the Company had received notification from Legal & General Group plc of a holding of 3.0 per cent of the Company's share capital.

On behalf of the Board of directors

David Green
Company Secretary
18 March 1999

# Consolidated Profit and Loss Account

Year ended 31 December 1998

| Note | General Business Technical Account | 1998 £m | 1997 £m |
|---|---|---|---|
| 1 | Gross premiums written | **310** | 306 |
| | Outward reinsurance premiums | **(15)** | (15) |
| | Premiums written, net of reinsurance | **295** | 291 |
| | Change in the gross provision for unearned premiums | **(3)** | (3) |
| | Change in the provision for unearned premiums, reinsurers' share | **1** | – |
| | Earned premiums, net of reinsurance | **293** | 288 |
| 1 | Allocated investment return transferred from the non-technical account | **41** | 49* |
| | Claims paid: | | |
| | Gross amount | **(234)** | (250) |
| | Reinsurers' share | **10** | 14 |
| | Net of reinsurance | **(224)** | (236) |
| | Change in the provision for claims: | | |
| | Gross amount | **19** | 33 |
| | Reinsurers' share | **4** | (6) |
| | Net of reinsurance | **23** | 27 |
| | Claims incurred, net of reinsurance | **(201)** | (209) |
| 6 | Net operating expenses | **(86)** | (83) |
| | Change in the equalisation provision | **(8)** | (7) |
| 1 | **Balance on the general business technical account** | **39** | 38* |

Gross premiums written and the balance on the general business technical account relate to continuing operations.

*Restated for altered basis of recognition of investment returns, as explained in note 3 on page 55.

# Consolidated Profit and Loss Account

Year ended 31 December 1998

| Note | Long-term Business Technical Account | 1998 £m | 1997 £m |
|---|---|---|---|
| | Gross premiums written: | | |
| 1 | Continuing operations | 10,640 | 9,641 |
| 9 | Discontinued operations | 423 | 665 |
| | Total | 11,063 | 10,306 |
| | Outward reinsurance premiums | (70) | (54) |
| | Earned premiums, net of reinsurance | 10,993 | 10,252 |
| 4 | Investment income | 8,516 | 6,211 |
| | Unrealised gains on investments | 3,842 | 5,668 |
| | Claims paid: | | |
| | Gross amount | (9,079) | (8,526) |
| | Reinsurers' share | 59 | 66 |
| | Net of reinsurance | (9,020) | (8,460) |
| | Change in the provision for claims: | | |
| | Gross amount | (12) | (42) |
| | Reinsurers' share | (2) | 1 |
| | Net of reinsurance | (14) | (41) |
| | Claims incurred, net of reinsurance | (9,034) | (8,501) |
| | Change in long-term business provision: | | |
| | Gross amount | (8,422) | (8,063) |
| | Reinsurers' share | 27 | 22 |
| | Net of reinsurance | (8,395) | (8,041) |
| | Change in provisions for linked liabilities, net of reinsurance | (1,439) | 228 |
| | Change in other technical provisions, net of reinsurance | (9,834) | (7,813) |
| 6 | Net operating expenses | (1,288) | (1,010) |
| 7 | Investment expenses and charges | (297) | (259) |
| 8 | Tax attributable to the long-term business | (686) | (574)* |
| | Allocated investment return transferred to the non-technical account | (5) | (21)* |
| | Transfers to the fund for future appropriations | (1,609) | (3,423) |
| | **Balance on the long-term business technical account** | 598 | 530* |
| | Analysed between: | | |
| | Continuing operations | 591 | 509 |
| 9 | Discontinued operations | 7 | 21 |
| | | 598 | 530 |

*Restated for altered basis of recognition of investment returns, as explained in note 3 on page 55.

| Note | Non-technical Account | 1998 £m | 1997 £m |
|---|---|---|---|
| | Balance on the general business technical account | 39 | 38* |
| | Balance on the long-term business technical account | 598 | 530* |
| 8 | Tax credit attributable to balance on the long-term business technical account | 227 | 240* |
| 1 | Balance on the long-term business technical account before tax | 825 | 770* |
| | **Profit on insurance activities** | 864 | 808* |
| | **Other activities** | | |
| 4 | Investment income | 224 | 222 |
| | Unrealised gains on investments | 30 | 33 |
| | Allocated investment return transferred from the long-term business technical account | 5 | 21* |
| 7 | Investment expenses and charges | (110) | (78) |
| | Allocated investment return transferred to the general business technical account | (41) | (49)* |
| | Other income: | | |
| | Investment management result | 43 | 44 |
| 9 | Profit on business disposals | 249 | 18 |
| | Reclassification of shareholder reserves of Australian operation | – | 204 |
| | Other charges: | | |
| | Corporate expenditure | (46) | (32) |
| | Banking | (77) | (22) |
| 1 | **Profit on other activities** | 277 | 361* |
| | **Profit on ordinary activities before tax** | 1,141 | 1,169 |
| 8 | Tax on profit on ordinary activities | (261) | (332) |
| 1 | **Profit for the financial year** | 880 | 837 |
| | Dividends: | | |
| | Interim [at 7.0p (6.4p) per share] | (136) | (124) |
| | Final [at 14.0p (12.7p) per share] | (271) | (246) |
| | Total dividends | (407) | (370) |
| 18 | **Retained profit for the financial year** | 473 | 467 |
| | **Reconciliation of operating profit to profit on ordinary activities** | | |
| 1 | Operating profit before tax based on longer term investment returns | 868 | 864* |
| | Short-term fluctuations in investment returns | 24 | 83* |
| 9 | Profit on business disposals | 249 | 18 |
| | Reclassification of shareholder reserves of Australian operation | – | 204 |
| | **Profit on ordinary activities before tax** | 1,141 | 1,169 |
| | **Basic earnings per share** | | |
| 1 | Based on operating profit after tax of £654m (£618m) and 1,942m (1,932m) shares | 33.7p | 32.0p* |
| | Adjustment from post-tax longer term to post-tax actual investment gains | 0.8p | 2.6p* |
| | Adjustment in respect of profit on business disposals | 10.8p | 0.9p |
| | Adjustment from reclassification of shareholder reserves of Australian operation | – | 7.8p |
| 1 | Based on profit for the financial year of £880m (£837m) and 1,942m (1,932m) shares | 45.3p | 43.3p |
| | **Diluted earnings per share** | | |
| 17 | Based on profit for the financial year of £880m (£837m) and 1,955m (1,947m) shares | 45.0p | 43.0p |
| | **Dividend per share** | 21.0p | 19.1p |

*Restated for altered basis of recognition of investment returns, as explained in note 3 on page 55.

# Consolidated Balance Sheet

31 December 1998

| Note | Assets | 1998 £m | 1997 £m |
|---|---|---|---|
| | **Intangible assets** | | |
| 9 | Goodwill | 59 | – |
| | **Investments** | | |
| 13 | Land and buildings | 7,298 | 6,313 |
| 14 | Investments in participating interests | 82 | 71 |
| 15 | Other financial investments | 93,014 | 85,335 |
| | | 100,394 | 91,719 |
| 16 | **Assets held to cover linked liabilities** | 9,737 | 9,911 |
| | **Reinsurers' share of technical provisions** | | |
| | Provision for unearned premiums | 3 | 2 |
| | Long-term business provision | 172 | 152 |
| | Claims outstanding | 60 | 63 |
| | Technical provisions for linked liabilities | 259 | 256 |
| | | 494 | 473 |
| | **Debtors** | | |
| | Debtors arising out of direct insurance operations: | | |
| | Policyholders | 254 | 160 |
| | Intermediaries | 3 | 4 |
| | Debtors arising out of reinsurance operations | 160 | 143 |
| | Other debtors: | | |
| | Tax recoverable | 269 | 262 |
| | Other | 598 | 583 |
| | | 1,284 | 1,152 |
| | **Other assets** | | |
| | Banking business assets | 2,397 | 1,053 |
| | Tangible assets | 141 | 115 |
| | Cash at bank and in hand | 684 | 490 |
| 17 | Own shares | 10 | – |
| | | 3,232 | 1,658 |
| | **Prepayments and accrued income** | | |
| | Accrued interest and rent | 779 | 780 |
| | Deferred acquisition costs: | | |
| | Long-term business | 2,580 | 2,479 |
| | General business | 15 | 20 |
| | Other prepayments and accrued income | 38 | 31 |
| | | 3,412 | 3,310 |
| | **Total assets** | 118,612 | 108,223 |

| Note | Liabilities | 1998 £m | 1997 £m |
|---|---|---|---|
| | **Capital and reserves** | | |
| 17 | Share capital | **98** | 97 |
| 17 | Share premium | **221** | 157 |
| 18 | Profit and loss account | **2,930** | 2,529 |
| | **Shareholders' funds – equity interests** | **3,249** | 2,783 |
| 1 | **Fund for future appropriations** | **20,879** | 19,301 |
| | **Technical provisions** | | |
| | Provision for unearned premiums | **158** | 155 |
| 19 | Long-term business provision | **76,553** | 69,512 |
| 21 | Claims outstanding | **704** | 716 |
| | Equalisation provision | **22** | 14 |
| | | **77,437** | 70,397 |
| | **Technical provisions for linked liabilities** | **9,996** | 10,167 |
| | **Provisions for other risks and charges** | | |
| 8 | Deferred tax | **465** | 449 |
| | **Creditors** | | |
| | Creditors arising out of direct insurance operations | **202** | 198 |
| | Creditors arising out of reinsurance operations | **13** | 22 |
| 20 | Debenture loans | **1,031** | 820 |
| | Amounts owed to credit institutions | **678** | 1,263 |
| | Other creditors including taxation and social security: | | |
| | Banking business liabilities | **2,271** | 996 |
| | Tax | **362** | 333 |
| | Final dividend | **271** | 246 |
| 21 | Other creditors | **1,619** | 1,149 |
| | | **6,447** | 5,027 |
| 21 | **Accruals and deferred income** | **139** | 99 |
| | **Total liabilities** | **118,612** | 108,223 |

# Statement of Total Recognised Gains and Losses

Year ended 31 December 1998

| | 1998 £m | 1997 £m |
|---|---|---|
| **Profit for the financial year** | **880** | 837 |
| Exchange movements | **(50)** | (43) |
| **Total recognised gains** | **830** | 794 |

# Reconciliation of Movement in Shareholders' Capital and Reserves

Year ended 31 December 1998

| | 1998 £m | 1997 £m |
|---|---|---|
| **Total recognised gains** | **830** | 794 |
| Goodwill on disposals and acquisitions of subsidiary undertakings | **28** | (421) |
| Goodwill on acquisitions of additional holding in associated undertaking | **–** | (21) |
| New share capital subscribed | **15** | 44 |
| Dividends | **(407)** | (370) |
| Net movement in shareholders' capital and reserves | **466** | 26 |
| Shareholders' capital and reserves at beginning of year | **2,783** | 2,757 |
| **Shareholders' capital and reserves at end of year** | **3,249** | 2,783 |

A statement of historical cost profits and losses has not been prepared as the amounts are not materially different from the profits for the financial year.

# Balance Sheet of the Company

31 December 1998

| Note | | 1998 £m | 1997 £m |
|---|---|---|---|
| | **Fixed assets** | | |
| | Investments: | | |
| 22 | Shares in subsidiary undertakings | **2,794** | 2,642 |
| 22 | Loans to subsidiary undertakings | **1,464** | 1,148 |
| | | **4,258** | 3,790 |
| | **Current assets** | | |
| | Debtors: | | |
| | Amounts owed by subsidiary undertakings | **291** | 291 |
| | Tax recoverable | **95** | 79 |
| | Other debtors | **103** | 53 |
| | Other investments | **9** | – |
| | Cash at bank and in hand | **155** | – |
| | | **653** | 423 |
| | **Less liabilities: amounts falling due within one year** | | |
| | Bank loans and overdrafts | **–** | (266) |
| | Amounts owed to subsidiary undertakings | **(434)** | (324) |
| | Tax payable | **–** | (27) |
| | Final dividend | **(271)** | (246) |
| | Other creditors | **(29)** | (8) |
| | | **(734)** | (871) |
| | **Net current liabilities** | **(81)** | (448) |
| | **Total assets less current liabilities** | **4,177** | 3,342 |
| | **Less liabilities: amounts falling due after more than one year** | | |
| 20 | Debenture loans | **(450)** | (152) |
| | Amounts owed to subsidiary undertakings | **(1,862)** | (1,359) |
| | | **(2,312)** | (1,511) |
| | **Total net assets** | **1,865** | 1,831 |
| | **Capital and reserves** | | |
| 17 | Share capital | **98** | 97 |
| 17 | Share premium | **221** | 157 |
| 23 | Retained profit | **1,546** | 1,577 |
| | **Shareholders' funds** | **1,865** | 1,831 |

The financial statements on pages 41 to 63 and the supplementary information on pages 67 to 73 were approved by the Board of directors on 18 March 1999.

**Sir Martin Jacomb, Chairman**

**Sir Peter Davis, Group Chief Executive**

**Jonathan Bloomer, Group Finance Director**

# Consolidated Cash Flow Statement

Year ended 31 December 1998

| Note | | 1998 £m | 1997 £m |
|---|---|---|---|
| | **Operations** | | |
| 26 | Net cash inflow from operations | **245** | 235 |
| | **Servicing of finance** | | |
| | Interest paid | **(85)** | (75) |
| | **Tax** | | |
| | Tax paid | **(138)** | (32) |
| | **Financial investment** | | |
| | Investment in long-term business operation of Scottish Amicable Life plc | **–** | (100) |
| | **Acquisitions and disposals** | | |
| 26 | Net cash inflow (outflow) from acquisitions and disposals of subsidiary undertakings | **345** | (522) |
| | Additional purchase of investment in associated undertaking | **–** | (35) |
| | | **345** | (557) |
| | **Equity dividends** | | |
| | Equity dividends paid | **(382)** | (345) |
| | **Financing** | | |
| 20 | Issue of debenture loan | **300** | – |
| | Bank loans raised | **98** | 389 |
| 20 | Repayment of debenture loan | **(84)** | (114) |
| | Issues of ordinary share capital (net of related transfer to share ownership trust) | **15** | 44 |
| | Net cash inflow from financing | **329** | 319 |
| | Net cash inflow (outflow) | **314** | (555) |
| | **The net cash inflow (outflow) was invested as follows:** | | |
| | Portfolio investments | | |
| | Purchases: | | |
| | Ordinary shares | **40** | 37 |
| | Fixed income securities | **1,733** | 1,758 |
| | | **1,773** | 1,795 |
| | Sales: | | |
| | Ordinary shares | **(22)** | (107) |
| | Fixed income securities | **(1,675)** | (126) |
| | Land and buildings | **–** | (20) |
| | | **(1,697)** | (253) |
| 26 | Net purchases of portfolio investments | **76** | 1,542 |
| 26 | Increase (decrease) in cash and short-term deposits | **238** | (2,097) |
| | | **314** | (555) |

In accordance with FRS 1, this statement shows only the cash flows of general business and shareholders' funds.

# Accounting Policies

## Disclosure Requirements

The consolidated financial statements are prepared in accordance with the provisions of Section 255A of and Schedule 9A to the Companies Act 1985 which cover the disclosures applicable to insurance companies and groups. The financial statements comply with applicable accounting standards and the revised Statement of Recommended Practice issued by the Association of British Insurers in December 1998. The balance sheet of the Company is prepared under the provisions of Schedule 4 to the Companies Act 1985, which apply to companies generally. The Company has taken advantage of the exemption under Section 230 of the Companies Act 1985 from presenting its own profit and loss account.

## Basis of Consolidation

The financial statements of the Group incorporate the assets, liabilities and results of the Company and its subsidiary undertakings. The results of subsidiaries acquired or disposed of are included in the financial statements from the date of acquisition or up to the effective date of disposal.

## Changes in Accounting Presentation

Consistent with the Statement of Recommended Practice, the basis of recognition of investment returns within operating profits (as disclosed in the profit and loss account and segmental analysis) has been altered. Investment returns credited to operating results, for investments attributable to shareholders, are now determined using the longer term rate of return (see note on investment return, below). Previously, investment gains were recognised in operating profits on a five year averaged basis.

The effect of the change of presentation is explained in note 3 on page 55.

In addition, the balance on the long-term business and general business technical accounts now incorporates longer term investment returns. Previously the balances on the technical accounts included investment returns arising in the year.

The changes of presentation have no effect on total profit before or after tax.

Profit before tax includes actual investment returns and exceptional items. The Company believes that operating profit (and related earnings per share) which as described above, includes longer term investment returns but excludes exceptional items, better reflects the Group's underlying performance.

## Investments

With the exception of fixed income securities of Jackson National Life and shares in subsidiary undertakings of the Company and associate undertakings of the Group, investments are shown at market value.

Properties are valued annually by the Group's qualified surveyors or by professional external valuers, at market value. In accordance with UK SSAP 19 no depreciation is provided on the properties as the directors consider that as these properties are held for investment, to depreciate them would not give a true and fair view. Depreciation is only one of the factors reflected in the valuations and the amount which might otherwise have been shown cannot reasonably be separately identified or quantified.

Consistent with the valuation of liabilities, fixed income securities at Jackson National Life are carried at amortised cost, subject to provisions for permanent diminution in value.

Shares in subsidiary undertakings in the balance sheet of the Company are shown at the lower of cost or estimated realisable value. The Group's interests in associate undertakings are carried at the Group's share of net assets. For unlisted securities market value is estimated by the directors.

## Investment Return

Investment return comprises investment income, including the amortisation of differences between cost and maturity value of those fixed income securities carried at amortised cost, together with realised and unrealised investment gains. UK dividend income is grossed up by the attaching tax credit.

Investment return in respect of long-term business, including that on assets matching solvency capital, is included in the long-term business technical account. Other investment return is included in the non-technical account.

For long-term business, an allocation is made from the long-term business technical account for the difference between the longer term investment return and the

# Accounting Policies

actual return on investments of the long-term business other than for assets backing the long-term business provision, the technical provisions for linked liabilities and the fund for future appropriations.

For general business, an allocation is made between the non-technical account and the general business technical account of the longer term investment return on investments matching general business provisions and solvency capital.

The longer term investment return is an estimate of the long term trend investment return for the relevant category of investments having regard to past performance, current trends and future expectations.

Operating profit, as disclosed within the profit and loss account on pages 41 to 43 and the segmental analysis in note 1 on pages 52 and 53 include investment returns for long-term business and general business (as described above) together with longer term returns for investments of other shareholders' funds.

### Long-term Business

The results are prepared in accordance with the modified statutory basis of accounting as set out in the Statement of Recommended Practice issued by the Association of British Insurers in December 1998. The main features of this method are as follows:

(i) Premiums and annuity considerations are accounted for when due. For unit-linked business, premiums are accounted for when the liabilities arising from the premiums are created.

(ii) Maturity claims are accounted for on the policy maturity date. Annuities are accounted for when the annuity becomes due for payment. Surrenders are accounted for when paid and death claims when notified.

(iii) Those costs of acquiring new insurance contracts, principally commission and certain costs associated with policy issue and underwriting, which are not matched by policy charges are amortised against margins in future revenues on the related insurance contracts, to the extent that the amounts are recoverable out of the margins.

(iv) Profits in respect of UK companies comprise actuarial surpluses allocated to shareholders adjusted, other than for with-profits business, for the deferral of acquisition costs and movements in the shareholders' interest in reserves held within long-term funds. Profits in respect of with-profits and unit-linked business are calculated initially at the post-tax level and have been grossed up at the effective rate of tax.

For with-profits business, unappropriated surplus is carried forward in the fund for future appropriations and no allocation is made to shareholders.

The fund for future appropriations comprises amounts arising in relation to participating policies and other non-linked policies, the allocation of which to policyholders or to shareholders has not been determined at the balance sheet date.

(v) Results of overseas subsidiaries are determined initially using local GAAP bases of accounting with subsequent adjustments where necessary to comply with the Group's accounting policies.

In the case of Jackson National Life, US GAAP results are adjusted to comply with UK SSAP 15 (deferred tax) and to show fixed income securities at amortised cost in the balance sheet. Further details are shown in note 2 on page 54.

### General Insurance

General insurance business is accounted for on an annual accounting basis.

(i) Premiums are accounted for when risks are assumed. In determining the result, the proportion of premiums written relating to periods of risk beyond the year end is carried forward to subsequent accounting periods as unearned premiums, calculated on a daily basis, so that earned premiums relate to risks carried during the accounting period. A similar treatment is applied to acquisition expenses.

(ii) Claims incurred comprise the settlement and handling costs of paid and outstanding claims arising from events occurring in the year and adjustments to prior years' claims provisions. Outstanding claims comprise claims incurred up to but not paid at the end of the accounting period whether reported or not.

(iii) An unexpired risks provision is established for any excess of expected claims and deferred acquisition costs over unearned premiums and investment return. The assessment of expected claims has regard to claims experience up to the end of the accounting period. No specific provision is made for major events occurring after this date.

(iv) An equalisation provision has been established in accordance with the requirements of the Insurance Companies (Reserves) Act 1995 in order to reduce the impact of claims volatility.

## Tax

Tax is charged on all taxable profits arising in the accounting period. Provision under the liability method is made for deferred tax arising from timing differences other than those considered likely to continue into the foreseeable future. Under this policy, deferred tax is not provided on earnings retained overseas.

## Foreign Currencies

Foreign currency revenue transactions are translated at average exchange rates for the year. Foreign currency assets and liabilities are translated at year end exchange rates. Exchange differences on long-term business and on net investments in foreign enterprises less matching borrowings are taken to reserves. Other exchange differences are included in the profit and loss account.

## Goodwill

Goodwill arising on consolidation is capitalised in the balance sheet at cost and amortised through the profit and loss account on a straight line basis over its useful economic life. The gain or loss on subsequent disposal of a subsidiary or associated undertaking will include any attributable unamortised goodwill.

Prior to 1998, purchased goodwill was eliminated against reserves. As permitted under the transitional arrangements of FRS 10, such amounts previously written off to reserves have not been reinstated as an asset, but will be charged to the profit and loss account on disposal of the business to which they relate.

## Tangible Assets

Tangible assets, principally computer equipment, fixtures and furniture, are capitalised and depreciated by equal annual instalments over their estimated useful lives.

## Leased Assets

Assets held under finance leases are capitalised at their fair market value.

## Pension Costs

Charges in respect of employers’ contributions to defined benefit schemes are calculated on a basis which spreads the costs over the service lives of scheme members. Contributions in respect of defined contribution schemes are recognised when incurred.

# Notes on the Financial Statements

## 1 Segmental Analysis

| (i) Results Summary | Operating profit 1998 £m | Items excluded from operating profit 1998 £m | Total 1998 £m | Operating profit 1997 £m | Items excluded from operating profit 1997 £m | Total 1997 £m |
|---|---|---|---|---|---|---|
| General business | 39 | – | 39 | 38* | – | 38* |
| Long-term business | 825 | – | 825 | 770 | – | 770 |
| Other activities | 4 | 273 | 277 | 56* | 305* | 361* |
| Profit before tax | 868 | 273 | 1,141 | 864* | 305* | 1,169 |
| Tax | (214) | (47) | (261) | (246)* | (86)* | (332) |
| **Profit after tax** | 654 | 226 | 880 | 618* | 219* | 837 |

| (ii) Analysis by Business Area | Long-term new business Single 1998 £m | Single 1997 £m | Regular 1998 £m | Regular 1997 £m | Gross premiums written 1998 £m | Gross premiums written 1997 £m | Operating profit (including longer term investment returns) 1998 £m | Operating profit (including longer term investment returns) 1997 £m |
|---|---|---|---|---|---|---|---|---|
| **UK operations** | | | | | | | | |
| Prudential Retail Financial Services | 1,821 | 1,819 | 192 | 245 | 3,236 | 3,233 | 333 | 323* |
| Retail IFA | 1,875 | 1,346 | 132 | 33 | 2,880 | 1,759 | 92 | 72 |
| Prudential Fund Management | 544 | 475 | 37 | 52 | 1,434 | 1,310 | 50 | 49 |
| Egg and Prudential Banking | – | – | – | – | – | – | (77) | (22) |
| **Total** | 4,240 | 3,640 | 361 | 330 | 7,550 | 6,302 | 398 | 422* |
| **Jackson National Life** | 2,835 | 2,914 | 28 | 37 | 3,237 | 3,340 | 411 | 367 |
| **Prudential Asia** | | | | | | | | |
| Long-term business | 114 | 226 | 79 | 120 | 532 | 653 | 23 | 20 |
| Development expenses | – | – | – | – | – | – | (10) | (9) |
| **Total** | 114 | 226 | 79 | 120 | 532 | 653 | 13 | 11 |
| **Shareholders' other income (note (v))** | – | – | – | – | – | – | 38 | 34* |
| **Total continuing operations (note (iii))** | 7,189 | 6,780 | 468 | 487 | 11,319 | 10,295 | 860 | 834* |
| Discontinued long-term business operations | 276 | 497 | 46 | 61 | 456 | 788 | 8 | 30 |
| **Group total** | 7,465 | 7,277 | 514 | 548 | 11,775 | 11,083 | 868 | 864* |

During 1998 the UK operations were reorganised into separate business units. The analysis shown above reflects this new structure.

| (iii) Analysis of Continuing Operations by Activity | Single 1998 £m | Single 1997 £m | Regular 1998 £m | Regular 1997 £m | Gross premiums 1998 £m | Gross premiums 1997 £m | Operating profit 1998 £m | Operating profit 1997 £m |
|---|---|---|---|---|---|---|---|---|
| Long-term business | 6,982 | 6,565 | 453 | 417 | 10,640 | 9,641 | 832 | 764 |
| Investment products | 207 | 215 | 15 | 70 | 369 | 348 | (15) | (24) |
| | 7,189 | 6,780 | 468 | 487 | 11,009 | 9,989 | 817 | 740 |
| General business (note (iv)) | – | – | – | – | 310 | 306 | 39 | 38* |
| Investment management | – | – | – | – | – | – | 43 | 44 |
| Banking | – | – | – | – | – | – | (77) | (22) |
| Shareholders' other income (note (v)) | – | – | – | – | – | – | 38 | 34* |
| **Total continuing operations** | 7,189 | 6,780 | 468 | 487 | 11,319 | 10,295 | 860 | 834* |

Single new business includes UK Department of Social Security rebates, increments under existing group pension schemes, and pensions vested into annuity contracts (at the annuity purchase price). Regular new business is determined on an annualised basis.

The geographical analyses of long-term business and general business premiums are based on the territory of the operating unit assuming the risk. Premiums by territory of risk are not materially different.

*Restated for altered basis of recognition of investment returns as explained in note 3 on page 55.

| (iv) General Business | Gross premiums written 1998 £m | Gross premiums written 1997 £m | Underwriting result 1998 £m | Underwriting result 1997 £m | Investment returns 1998 £m | Investment returns 1997 £m | Operating profit (including longer term investment returns) 1998 £m | Operating profit (including longer term investment returns) 1997 £m |
|---|---|---|---|---|---|---|---|---|
| **Continuing operations** | | | | | | | | |
| **UK operations** | | | | | | | | |
| Home | **273** | 268 | **19** | 14 | **21** | 22* | **40** | 36* |
| Motor | **37** | 38 | **(7)** | (5) | **6** | 7* | **(1)** | 2* |
| **Total continuing operations** | **310** | 306 | **12** | 9 | **27** | 29* | **39** | 38* |
| **Discontinued operations** | **–** | – | **(14)** | (20) | **14** | 20 | **–** | – |
| **Group total** | **310** | 306 | **(2)** | (11) | **41** | 49* | **39** | 38* |

| (v) Shareholders' Other Income | Operating profit (including longer term investment returns) 1998 £m | Operating profit (including longer term investment returns) 1997 £m |
|---|---|---|
| Investment return | **189** | 141* |
| Corporate expenditure | **(46)** | (32) |
| Interest payable | **(105)** | (75) |
| **Group total** | **38** | 34* |

| (vi) Items Excluded from Operating Profit | | |
|---|---|---|
| Short-term fluctuations in investment returns | **24** | 83* |
| Profit on business disposals | **249** | 18 |
| Reclassification of shareholder reserves of Australian operation | **–** | 204 |
| **Group total** | **273** | 305* |

**(vii) Net Assets**

A segmental analysis of the fund for future appropriations and the technical provisions net of reinsurance is set out below which, although liabilities, provide a more useful indication than net assets of the assets supporting the business.

| Analysis of Fund for Future Appropriations and Net Technical Provisions | 1998 £m | 1997 £m |
|---|---|---|
| Fund for future appropriations: | | |
| Scottish Amicable Insurance Fund of Prudential Assurance Company (closed to new business and wholly attributable, but not allocated, to policyholders) | **2,478** | 2,248 |
| Other Group companies (principally the with profits fund of Prudential Assurance Company) | **18,401** | 17,053 |
| | **20,879** | 19,301 |
| Technical provisions (net of reinsurance) | **86,939** | 80,091 |
| | **107,818** | 99,392 |
| Comprising: | | |
| UK operations | **86,780** | 76,985 |
| Jackson National Life | **19,423** | 18,032 |
| Prudential Asia | **1,615** | 1,314 |
| Discontinued operations | **–** | 3,061 |
| **Group total** | **107,818** | 99,392 |

*Restated for altered basis of recognition of investment returns as explained in note 3 on page 55.

# Notes on the Financial Statements

| Analysis of Shareholders' Capital and Reserves | 1998 £m | 1997 £m |
|---|---|---|
| UK operations | 562 | 427 |
| Jackson National Life | 1,547 | 1,300 |
| Prudential Asia | 123 | 46 |
| Retained centrally | 2,299 | 1,823 |
| Discontinued operations | – | 223 |
| | 4,531 | 3,819 |
| Central borrowings | (1,282) | (1,036) |
| **Group total** | 3,249 | 2,783 |

In the analysis of shareholders' capital and reserves, no interest is recognised in respect of the unattributed assets held within the main UK with-profits fund.

## 2 Jackson National Life

The results of Jackson National Life are consolidated into the Group accounts based on US Generally Accepted Accounting Principles (US GAAP). However, certain adjustments are made to the US GAAP results to comply with the Group's accounting policies, principally:
(i) For Group reporting purposes, all fixed income securities are carried at amortised cost subject to provisions for permanent diminutions in value. Under US GAAP, fixed income securities classified as 'available for sale' are carried at market value with movements in unrealised gains and losses, including related changes in deferred acquisition costs and applicable tax, recognised as movements in shareholders' reserves.
(ii) For the purposes of determining Group operating profit, realised investment gains and losses are recognised on a five year averaged basis. Under US GAAP, these items are not included in operating income but are included in profit before tax.
(iii) Under US GAAP, deferred tax provisions are generally established in respect of all timing differences whereas, under UK SSAP 15, provision is made only for timing differences which are expected to reverse in the foreseeable future.
Reconciliations between the US GAAP and Group reporting bases are shown below.

| Profit Before Tax | 1998 US$m | 1997 US$m | 1998 £m | 1997 £m |
|---|---|---|---|---|
| US GAAP operating income | 637 | 538 | 386 | 328 |
| Averaged investment gains | 42 | 64 | 25 | 39 |
| Operating profit per Group accounts | 679 | 602 | 411 | 367 |
| Adjustment from averaged to actual investment gains | 4 | 16 | 2 | 10 |
| Profit before tax per Group accounts and per US GAAP | 683 | 618 | 413 | 377 |

| Shareholders' Funds | 1998 US$m | 1997 US$m | 1998 £m | 1997 £m |
|---|---|---|---|---|
| US GAAP shareholders' funds | 2,896 | 2,615 | 1,740 | 1,589 |
| Investment value and related adjustments | (292) | (379) | (175) | (230) |
| Deferred tax asset eliminated | (127) | (161) | (76) | (98) |
| Other adjustments | 97 | 64 | 58 | 39 |
| Shareholders' funds per Group accounts | 2,574 | 2,139 | 1,547 | 1,300 |

| Exchange rates used for translation were: | 1998 | 1997 |
|---|---|---|
| Average rate for the year for profit before tax | 1.66 | 1.64 |
| Year end rate for shareholders' funds | 1.66 | 1.65 |

## 3 Investment Return

(i) Change of presentation
Consistent with the recommendations included within the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers in December 1998, the accounting policy for recognition of investment returns has been altered. Under the new policy, investment returns credited to operating results, for investments attributable to shareholders, are determined using the longer term rate of return or (by five year averaging of gains) an estimate thereof. Previously, all gains on these investments were recognised in operating results on a five year averaged basis. The basis for determining tax charges allocated to operating profits has also been altered to reflect the changes made at the pre-tax level.

| The change of presentation has the following effects on the results: | 1998 £m | 1997 £m |
|---|---|---|
| Total operating profit before tax: | | |
| Before change | **893** | 895 |
| After change | **868** | 864 |
| Total operating profit after tax: | | |
| Before change | **673** | 644 |
| After change | **654** | 618 |
| Operating earnings per share: | | |
| Before change | **34.7p** | 33.3p |
| After change | **33.7p** | 32.0p |

The changes have no effect on total profit before or after tax.

(ii) Longer term investment return
The longer term rate of return is based on historical real rates of return and current inflation expectations adjusted for consensus economic and investment forecasts. The only significant general business and shareholder investments which require calculation of a longer term rate of return are UK equities. For these investments the longer term rate of return (net of advance corporation tax credits) has been taken to be 8.1% (9.2%). The net longer term dividend yield has been assumed to be 2.6% (3.0%).

For long-term business the most significant element of gains on investments that are attributable to shareholders arises in Jackson National Life. Gains made on realisation of such investments, which are principally fixed income securities, continue to be averaged over five years for the purposes of calculating operating results. From 1998 onwards the gains subject to averaging are determined after deduction of related amortisation charges for deferred acquisition costs.

(iii) Comparison of longer term investment gains with actual investment gains
For the Group's continuing operations with investment portfolios that are both attributable to shareholders and subject to short-term volatility, a comparison of actual and longer term gains is set out below.

| | 1994 to 1998 £m | 1993 to 1997 £m |
|---|---|---|
| Actual gains attributable to shareholders: | | |
| Jackson National Life | **131** | 205 |
| General business and shareholders | **242** | 286 |
| | **373** | 491 |
| Longer term gains credited to operating results: | | |
| Jackson National Life | **161** | 149 |
| General business and shareholders | **142** | 146 |
| | **303** | 295 |

No distinction has been made between gains attributable to general business and shareholders as the relevant assets are managed on a combined basis.

## 4 Investment Income

| | Long-term business 1998 £m | Long-term business 1997 £m | Non-technical account 1998 £m | Non-technical account 1997 £m |
|---|---|---|---|---|
| Income from: | | | | |
| Land and buildings | **608** | 509 | **–** | – |
| Listed investments | **4,247** | 3,704 | **110** | 89 |
| Other investments | **613** | 493 | **99** | 78 |
| | **5,468** | 4,706 | **209** | 167 |
| Gains on the realisation of investments | **3,048** | 1,505 | **15** | 55 |
| **Total** | **8,516** | 6,211 | **224** | 222 |

# Notes on the Financial Statements

## 5 Policyholder Bonuses

Bonuses added during the year are included in the change in long-term business provision or, where the policy is no longer in force, in claims incurred. The total cost of bonuses was £3,056m (£2,606m).

## 6 Net Operating Expenses

| | Long-term business | | General business | |
|---|---|---|---|---|
| | **1998 £m** | 1997 £m | **1998 £m** | 1997 £m |
| Acquisition costs | **874** | 706 | **29** | 39 |
| Change in deferred acquisition costs | **(126)** | (145) | **5** | 1 |
| Administrative expenses | **510** | 446 | **55** | 43 |
| Reinsurance commissions and profit participation | **30** | 3 | **(3)** | – |
| Total | **1,288** | 1,010 | **86** | 83 |

## 7 Investment Expenses and Charges

| | Long-term business | | Non-technical account | |
|---|---|---|---|---|
| | **1998 £m** | 1997 £m | **1998 £m** | 1997 £m |
| Interest on bank loans and overdrafts | **29** | 16 | **40** | 37 |
| Interest on other loans | **9** | 2 | **65** | 38 |
| **Total interest payable** | **38** | 18 | **105** | 75 |
| Investment management expenses | **259** | 241 | **5** | 3 |
| Total | **297** | 259 | **110** | 78 |

## 8 Tax

| Tax Charged to the Long-term Business Technical Account and the Non-technical Account | Attributable to long-term funds | | Attributable to shareholders' profits | |
|---|---|---|---|---|
| | **1998 £m** | 1997 £m | **1998 £m** | 1997 £m |
| UK corporation tax | **301** | 139 | **29** | 16 |
| Double tax relief | **(11)** | (11) | **(3)** | (10) |
| Tax on franked investment income | **166** | 155 | **3** | 2 |
| Overseas tax | **159** | 207* | **3** | 82* |
| Prior year adjustments | **(3)** | 53 | **(1)** | (23) |
| | **612** | 543* | **31** | 67* |
| Deferred tax | **74** | 31 | **3** | 25 |
| | **686** | 574* | **34** | 92* |
| Tax credit attributable to balance on the long-term business technical account | **–** | – | **227** | 240* |
| Total | **686** | 574* | **261** | 332 |
| Analysed between: | | | | |
| Tax on operating profit | **–** | – | **214** | 246* |
| Tax on short-term fluctuations in investment gains | **–** | – | **9** | 33* |
| Tax on profit on business disposals | **–** | – | **38** | – |
| Tax on reclassification of shareholders' reserves of Australian operation | **–** | – | **–** | 53 |
| Total | **–** | – | **261** | 332 |

*Restated for altered basis of recognition of investment returns as explained in note 3 on page 55.

| Deferred tax | Liability provided (asset recognised) 1998 £m | 1997 £m | Liability not provided (asset not recognised) 1998 £m | 1997 £m |
|---|---|---|---|---|
| Deferred acquisition costs | 319 | 343 | – | – |
| Short-term timing differences | (255) | (196) | (91) | (94) |
| Long-term business reserves | – | – | 97 | 88 |
| General insurance technical provisions | – | – | – | (10) |
| Capital allowances | (1) | (1) | (3) | (2) |
| Closure cost provisions | (11) | (4) | – | – |
| Unrealised gains on investments | 413 | 307 | 2,685 | 2,203 |
| **Total** | 465 | 449 | 2,688 | 2,185 |

The principal reconciling item between the movement during 1998 on the balance sheet provision for deferred tax, and the charge for deferred tax included in the profit and loss account, is the release of provisions held by the Group's Australasian operations which were sold in the year.

## 9 Acquisitions and Disposals

On 4 June 1998, regulatory approval was received for the purchase of a controlling interest in the Group's Malaysian operation, Prudential Assurance Malaysia Berhad. Previously, the Group's interest in the operation was accounted for as an associated company. The effect of the transaction, which has been accounted for as an acquisition, was:

| | 1998 £m |
|---|---|
| Fair value of consideration (including expenses) for acquisition and funding of ordinary and preference share capital | 123 |
| Net assets: | |
| Book value before acquisition | 9 |
| Fair value adjustment | 55 |
| | 64 |
| Goodwill recognised as an asset in the balance sheet | 59 |

The fair value adjustment of £55m shown above is for the estimated shareholders' accrued interest in surpluses expected to emerge on business in force. The goodwill will be amortised from 1 January 1999 over a period of 20 years.

On 17 August 1998 the Group announced the sale of its Australasian businesses (principally Prudential Corporation Australia Limited and The Prudential Assurance Company New Zealand Limited) to The Colonial Mutual Life Assurance Society Limited for total proceeds of A$1.35bn. Completion took place on 30 September and the Group received £468m in cash, net of expenses. The profit on disposal before tax of £249m takes account of £191m in respect of net assets at the date of disposal and, in accordance with UITF3, a further £28m for goodwill written off to reserves on acquisition. An analysis of the long-term business technical account between continuing and discontinued operations is set out below:

| Long-term business | Continuing operations 1998 £m | Discontinued operations 1998 £m | Total 1998 £m |
|---|---|---|---|
| Gross premiums written | 10,640 | 423 | 11,063 |
| Outwards reinsurance premiums | (67) | (3) | (70) |
| Earned premiums, net of reinsurance | 10,573 | 420 | 10,993 |
| Investment income | 8,367 | 149 | 8,516 |
| Unrealised gains on investments | 3,835 | 7 | 3,842 |
| Claims incurred, net of reinsurance | (8,343) | (691) | (9,034) |
| Change in other technical provisions, net of reinsurance | (10,056) | 222 | (9,834) |
| Net operating expenses | (1,218) | (70) | (1,288) |
| Investment expenses and charges | (277) | (20) | (297) |
| Tax attributable to the long-term business | (676) | (10) | (686) |
| Allocated investment return transferred to the non-technical account | (5) | – | (5) |
| Transfers to the fund for future appropriations | (1,609) | – | (1,609) |
| **Balance on the long-term business technical account** | 591 | 7 | 598 |

# Notes on the Financial Statements

## 10 Information on Staff

| The average numbers of staff employed by the Group during the year were: | 1998 | 1997 |
|---|---|---|
| UK operations | 19,090 | 18,369 |
| Jackson National Life | 1,439 | 1,293 |
| Prudential Asia | 1,328 | 1,155 |
| Discontinued operations | 977 | 1,303 |
| **Group total** | 22,834 | 22,120 |

| The costs of employment were: | 1998 £m | 1997 £m |
|---|---|---|
| Wages and salaries | 576 | 488 |
| Social security costs | 44 | 39 |
| Other pension costs (see below) | 41 | 33 |
| **Group total** | 661 | 560 |

The Group operates a number of pension schemes around the world. The largest scheme is the Group's main United Kingdom scheme which covers approximately 74% of members of all Group pension schemes. This scheme is of the defined benefit type with scheme assets held in separate trustee administered funds and was last valued as at 5 April 1996 by a qualified actuary who was an employee of the Group.

The projected accrued benefits method was used and the principal actuarial assumptions adopted were investment return 8.5% per annum, pensionable earnings growth 7% per annum, increases to pensions in payment 4.5% per annum and dividend growth 4.5% per annum.

The market value of scheme assets at that date was £3,275m and the actuarial value of the assets was sufficient to cover 116% of the benefits that had accrued to members, allowing for expected future increases in earnings. As a result of the actuarial valuation, the employer's contribution rate became the minimum prescribed under the scheme rules, currently equivalent to 10.25% of pensionable earnings.
£4m (£5m) of the pension costs related to overseas schemes.

## 11 Directors' Remuneration

Information on directors' remuneration is given in the Remuneration Report on pages 33 to 38.
No director had an interest in shares, transactions or arrangements which requires disclosure, other than those given in the above Report.

## 12 Fees Payable to Audit Firms

Statutory audit fees payable to PricewaterhouseCoopers were £2.0m (£2.0m) including £0.1m (£0.1m) in respect of the Company.
Further fees payable comprised:

| | 1998 £m | 1997 £m |
|---|---|---|
| Audit related services: | | |
| Regulatory returns and achieved profits basis audits | 0.5 | 0.5 |
| Tax and accounting advice | 0.5 | 0.5 |
| Acquisitions and disposals | – | 0.7 |
| Consultancy services | 7.7 | 0.8 |
| **Total** | 8.7 | 2.5 |

Consultancy services for 1998 included £2.4m payable to Coopers & Lybrand prior to the date of appointment of PricewaterhouseCoopers as auditors. Included in the total of £8.7m are fees of £8.2m (£1.9m) for work performed in the United Kingdom.

## 13 Land and Buildings

| | 1998 £m | 1997 £m |
|---|---|---|
| Current value: | | |
| Freehold | 4,317 | 4,084 |
| Leasehold with a term of over 50 years | 2,865 | 2,089 |
| Leasehold with a term of less than 50 years | 116 | 140 |
| **Total** | 7,298 | 6,313 |

The cost of land and buildings was £4,971m (£4,338m). The value of land and buildings occupied by the Group was £111m (£144m).

## 14 Investments in Participating Interests

| | Cost 1998 £m | Cost 1997 £m | Current value 1998 £m | Current value 1997 £m |
|---|---|---|---|---|
| Interests in associated undertakings | **146** | 156 | **58** | 61 |
| Other participating interests | **24** | 10 | **24** | 10 |
| **Total** | **170** | 166 | **82** | 71 |

Interests in associated undertakings are included in the consolidated balance sheet as the Group's share of the undertakings' net assets.

### Movement in Interests in Associated Undertakings

| | Share of capital 1998 £m | Share of reserves 1998 £m | Share of investment 1998 £m |
|---|---|---|---|
| Profit for the year after taxation | **–** | **3** | **3** |
| Dividends received | **–** | **(1)** | **(1)** |
| Associate now recognised as subsidiary | **(5)** | **–** | **(5)** |
| Movement in interests in associated undertakings | **(5)** | **2** | **(3)** |
| Balance at beginning of year | **30** | **31** | **61** |
| Balance at end of year | **25** | **33** | **58** |

The associated undertaking at the end of the year is St James's Place Capital plc, which is incorporated in England and Wales and is listed on a recognised investment exchange. The proportion of ordinary shares held is 25.8% and all shares are held by a subsidiary company. The principal activity of the undertaking is the transacting of insurance business.

## 15 Other Financial Investments

| | Cost 1998 £m | Cost 1997 £m | Current value 1998 £m | Current value 1997 £m |
|---|---|---|---|---|
| Shares and other variable yield securities and units in unit trusts | **23,113** | 21,798 | **49,088** | 45,999 |
| Debt securities and other fixed income securities – carried at market value | **18,685** | 16,265 | **21,283** | 17,847 |
| Debt securities and other fixed income securities – carried at amortised cost | **15,847** | 15,538 | **15,902** | 15,572 |
| Loans secured by mortgages | **1,849** | 1,582 | **1,938** | 1,655 |
| Loans to policyholders secured by insurance policies | **583** | 591 | **583** | 591 |
| Other loans | **57** | 98 | **68** | 98 |
| Deposits with credit institutions | **3,917** | 3,420 | **3,917** | 3,420 |
| Other | **221** | 154 | **235** | 153 |
| **Total** | **64,272** | 59,446 | **93,014** | 85,335 |

| Amounts included in the above ascribable to listed investments were: | 1998 £m | 1997 £m |
|---|---|---|
| Shares and other variable yield securities and units in unit trusts | **48,108** | 45,734 |
| Debt securities and other fixed income securities – carried at market value | **19,406** | 16,347 |
| Debt securities and other fixed income securities – carried at amortised cost | **13,316** | 13,032 |
| **Total** | **80,830** | 75,113 |

The market value of debt securities and other fixed income securities valued at amortised cost was £16,411m (£15,888m). All debt securities carried at amortised cost are held by long-term business operations.

For those debt securities and other fixed income securities valued at amortised cost where the maturity value exceeded purchase price, the unamortised difference at the year end was £195m (£170m). There were no investments valued at amortised cost where the purchase price exceeded maturity value.

## 16 Assets Held to Cover Linked Liabilities

| | Cost 1998 £m | Cost 1997 £m | Current value 1998 £m | Current value 1997 £m |
|---|---|---|---|---|
| Assets held to cover linked liabilities | **7,625** | 8,341 | **9,737** | 9,911 |

Current value includes £3,243m (£2,733m) in respect of managed funds.

# Notes on the Financial Statements

## 17 Share Capital and Share Premium

The authorised share capital of the Company is £120m comprising 2,400,000,000 shares of 5p each.

| Issued shares of 5p each fully paid | Number of shares | Share capital 1998 £m | Share premium 1998 £m |
|---|---|---|---|
| At beginning of year | **1,938,989,150** | **97.0** | **157.4** |
| Shares issued under share option schemes and to qualifying employee share ownership trust | **9,677,020** | **0.5** | **63.7** |
| At end of year | **1,948,666,170** | **97.5** | **221.1** |

At 31 December 1998 there were options subsisting under share option schemes to subscribe for 28,126,716 (35,110,240) shares at prices ranging from 163 pence to 759 pence (150 pence to 505 pence) and exercisable by the year 2005 (2005).

The Company has established trusts to facilitate the delivery of shares under employee incentive plans and savings-related share option schemes. At 31 December 1998, 8.3m Prudential Corporation shares with a market value of £75m were held in trusts relating to incentive plans. The arrangements for distribution of shares held in these trusts to employees and for entitlement to dividends depend upon the particular terms of each incentive plan. The costs of share awards under the plans are charged to the profit and loss account over the period of service to which awards are made. Shares held in these trusts are conditionally gifted to employees. At 31 December 1998, 4.1m shares were held by a qualifying employee share ownership trust. These shares are expected to be fully distributed shortly after 1 June 1999 on maturity of a savings-related share option scheme. The exercise price under this scheme is £2.49 and the expected proceeds of £10m relating to these shares have been included in the consolidated balance sheet.

A reconciliation of the weighted average number of ordinary shares used as the denominator in calculating basic and diluted earnings per share is set out below:

| | 1998 m | 1997 m |
|---|---|---|
| Weighted average number of shares in basic earnings per share calculation | **1,942** | 1,932 |
| Number of shares under option at end of year | **28** | 35 |
| Number of shares held by qualifying employee share ownership trust | **(4)** | – |
| Number of shares that would have been issued at fair value | **(11)** | (20) |
| Weighted average number of shares in diluted earnings per share calculation | **1,955** | 1,947 |

## 18 Group Profit and Loss Account Reserve

| | 1998 £m | 1997 £m |
|---|---|---|
| At beginning of year | **2,529** | 2,530 |
| Retained profit for the financial year | **473** | 467 |
| Exchange movements | **(50)** | (43) |
| Goodwill reversed on disposals (charged on acquisitions) | **28** | (442) |
| Charge in respect of shares issued to qualifying employee share ownership trust | **(50)** | – |
| Transfer from share premium in respect of shares issued in lieu of cash dividends | **–** | 17 |
| At end of year | **2,930** | 2,529 |

## 19 Long-term Business Provision

The principal valuation methods and assumptions are as follows:

(i) *UK operations and Prudential Asia*

The main relevant products are with-profits deposit administration, other unitised and non-unitised with-profits contracts and non-profit pension annuities in course of payment. The calculation of the provision is based on fund value in the case of deposit administration and unitised contracts and the net premium method for non-unitised contracts. No explicit provision is made for future bonuses but the provision includes the cost of bonuses added following the valuation at the end of 1998.

The assumed interest rates for UK with-profits contracts valued by the net premium method range from 3%-5% whilst the rates of interest for pension annuities in course of payment range from 4.75%-5.3%. Mortality rates are based on recognised mortality tables suitably adjusted to reflect actual experience.

Additional provisions are held to meet the expenses, compensation costs and guarantees arising in respect of the FSA pensions review and to meet costs associated with guaranteed annuity options offered by Scottish Amicable Life Assurance Society.

(ii) *Jackson National Life*

The main relevant products are interest sensitive deferred annuities and whole life contracts, guaranteed investment contracts, equity linked indexed deferred annuities and term assurance.

The interest sensitive and guaranteed investment products are valued at policyholder account value. Equity linked indexed deferred annuities are valued at a basic liability equal to the policyholder guaranteed account value. Options are purchased which match very closely the liabilities arising from any excess of indexed values over guaranteed values, and the valuation of these options matches the valuation of the additional liabilities relating to any such excess.

The term assurances are valued on a net premium method, with allowance made for discontinuances and claim expenses. Mortality rates are based on published tables suitably adjusted to reflect actual experience. Rates of interest vary between 6.0% and 9.5%.

## 20 Borrowings

| | 1998 £m | 1997 £m |
|---|---|---|
| Debenture loans (unsecured) | | |
| SF200m 4.75% Guaranteed Bonds 1998 | – | 84 |
| US$300m 8.25% Guaranteed Bonds 2001 | 181 | 182 |
| US$250m 7.125% Bonds 2005 | 150 | 152 |
| £150m 9.375% Guaranteed Bonds 2007 | 150 | 150 |
| £300m 6.875% Bonds 2023 | 300 | – |
| US$250m 8.15% Surplus Notes 2027 | 150 | 152 |
| £100m 8.5% undated subordinated Guaranteed Bonds | 100 | 100 |
| **Total debenture loans** | 1,031 | 820 |
| Currency translation liability on swap transaction | – | 2 |
| Bank loans and overdrafts repayable on demand | 64 | 308 |
| Commercial paper 1999 | 442 | 166 |
| Secured senior and subordinated debt issued by investment subsidiaries managed by Prudential Portfolio Managers | 42 | 58 |
| **Total borrowings** | 1,579 | 1,354 |
| Comprising: | | |
| Holding company and finance subsidiaries | 1,223 | 1,002 |
| Other central companies | 59 | 34 |
| Total central borrowings | 1,282 | 1,036 |
| Long-term business operations | 255 | 260 |
| Investment subsidiaries managed by Prudential Portfolio Managers | 42 | 58 |
| **Total borrowings** | 1,579 | 1,354 |
| Borrowings are repayable as follows: | | |
| Within one year or on demand | 506 | 560 |
| Between one and two years | – | – |
| Between two and five years | 181 | 182 |
| After five years | 892 | 612 |
| **Total borrowings** | 1,579 | 1,354 |

**Notes:**

(i) The SF200m loan was repaid on maturity in January 1998.

(ii) The Company's debenture loans comprised the US$250m 7.125% Bonds 2005 and the £300m 6.875% Bonds 2023.

(iii) Under the terms of the Group's arrangements with its main United Kingdom banker, the bank has a right of set off between credit balances (other than those of long-term funds), and all overdrawn balances of those Group undertakings with similar arrangements.

(iv) Borrowings of long-term business operations comprised:

| | 1998 £m | 1997 £m |
|---|---|---|
| US$250m 8.15% surplus notes 2027 issued by Jackson National Life | 150 | 152 |
| £100m 8.5% undated subordinated Guaranteed Bonds issued by Scottish Amicable Finance plc (a subsidiary of the Scottish Amicable Insurance Fund of The Prudential Assurance Company Limited) | 100 | 100 |
| Bank overdrafts | 5 | 8 |
| | 255 | 260 |

The interests of the holders of the bonds issued by Scottish Amicable Finance plc are subordinate to the entitlements of the policyholders of the Scottish Amicable Insurance Fund.

(v) The senior debt issued by investment subsidiaries managed by Prudential Portfolio Managers is secured on the investments held by the relevant subsidiaries. The interests of the holders of the subordinated debt issued by these subsidiaries are subordinate to the entitlements of the holders of the senior debt. For both classes of debt the holders do not have recourse beyond the assets of these subsidiaries.

(vi) Amounts owed to credit institutions included £554m (£867m) of obligations of Jackson National Life under sale and repurchase agreements.

## 21 Reclassification of Certain Liabilities

The 1997 comparative figures for claims outstanding, other creditors and accruals and deferred income are respectively £22m, £37m and £46m higher than that previously reported following a reclassification of provisions for other risks and charges.

# Notes on the Financial Statements

## 22 Investments of the Company

| | Shares in subsidiary undertakings 1998 £m | Loans to subsidiary undertakings 1998 £m |
|---|---|---|
| At beginning of year | 2,642 | 1,148 |
| Investment in subsidiary undertakings | 152 | – |
| Exchange rate movements | – | (2) |
| Advances of new loans | – | 319 |
| Repayments of loans | – | (1) |
| At end of year | 2,794 | 1,464 |

## 23 Profit of the Company

The profit of the Company for the year was £376m (£254m). After dividends of £407m (£370m), retained profit at 31 December 1998 amounted to £1,546m (£1,577m).

## 24 Subsidiary Undertakings

The principal subsidiary undertakings of the Company at 31 December 1998 were:

| | Main activity | Country of incorporation |
|---|---|---|
| Holborn Finance Limited Liability Company* | Investment | USA |
| Jackson National Life Insurance Company* | Insurance | USA |
| Prudential Annuities Limited* | Insurance | England and Wales |
| The Prudential Assurance Company Limited | Insurance | England and Wales |
| Prudential Assurance Company Singapore (Pte) Limited* | Insurance | Singapore |
| Prudential Banking plc | Banking | England and Wales |
| Prudential Finance BV* | Finance | The Netherlands |
| Prudential Portfolio Managers Limited | Investment management | England and Wales |
| Scottish Amicable Life plc* | Insurance | Scotland |

*owned by a subsidiary undertaking of the Company.

Each undertaking has only one class of ordinary shares, all of which are held by the Group, and operates mainly in its country of incorporation. The cumulative goodwill charged against the Group's reserves arising on acquisitions of subsidiary undertakings that remain part of the Group amounted to £679m (£707m).

## 25 Contingent Liabilities

The Group has contingent liabilities in respect of insurance and other agreements entered into in the normal course of business and in respect of litigation arising therefrom.

The provision of £1.1 billion associated with the review of pension mis-selling in the United Kingdom has been met from the free assets of the long-term fund of The Prudential Assurance Company Limited. Given the strength of the long-term fund, the directors are of the opinion that charging the provision to the free assets of the fund will not have an adverse effect on the levels of bonus paid to policyholders or their reasonable expectations. In the unlikely event of this proving not to be the case, the directors' intention would be that an appropriate contribution to the long-term fund be made from shareholders' funds. In view of the uncertainty, it is not practicable to estimate the level of this potential contribution.

## 26 Cash Flow

**Reconciliation of Operating Profit to Net Cash Inflow from Operations**

| | 1998 £m | 1997 £m |
|---|---|---|
| Operating profit before tax | 868 | 864* |
| Add back interest charged to operating profit | 105 | 75 |
| Adjustments for non-cash items: | | |
| Tax on long-term business profits and franked investment income | (230) | (242) |
| General business and shareholder longer term investment gains | (23) | (24)* |
| Decrease in general business technical provisions | (39) | (69) |
| (Increase) decrease in reinsurance recoverable | (6) | 11 |
| Depreciation | 18 | 16 |
| Increase in banking assets (net of liabilities) | (69) | (14) |
| Other (principally amounts reinvested in long-term business operations) | (379) | (382) |
| Net cash inflow from operations | 245 | 235 |

*Restated for altered basis of recognition of investment returns as explained in note 3 on page 55.

| Changes in Investments Net of Financing | 1998 £m | 1997 £m |
|---|---|---|
| Increase (decrease) in cash and short-term deposits | 238 | (2,097) |
| Net purchases of portfolio investments | 76 | 1,542 |
| Increase in loans | (314) | (275) |
| Share capital issued | (15) | (44) |
| Movements arising from cash flow | (15) | (874) |
| Investment appreciation | 42 | 81 |
| Investments transferred to owner of former subsidiary | – | (160) |
| Exchange translation and other | (15) | (39) |
| Transfer to retained profit in respect of shares issued in lieu of cash dividends | – | 17 |
| Portfolio investments net of financing at beginning of year | 1,004 | 1,979 |
| Portfolio investments net of financing at end of year | 1,016 | 1,004 |
| Represented by: | | |
| Investments (including short-term deposits) | 2,339 | 2,245 |
| Cash at bank and in hand | 270 | 107 |
| Borrowings | (1,324) | (1,094) |
| Share capital and share premium | (319) | (254) |
| Charge to group profit and loss account reserve in respect of shares issued to qualifying employee share ownership trust | 50 | – |
| Total | 1,016 | 1,004 |

| Reconciliation of Investments to Balance Sheet | 1998 £m | 1997 £m |
|---|---|---|
| General business and shareholders (as above) | 2,339 | 2,245 |
| Long-term business | 97,973 | 89,403 |
| Total portfolio investments per balance sheet | 100,312 | 91,648 |

| Reconciliation of Cash to Balance Sheet | 1998 £m | 1997 £m |
|---|---|---|
| General business and shareholders (as above) | 270 | 107 |
| Long-term business | 414 | 383 |
| Total cash at bank and in hand per balance sheet | 684 | 490 |

| Reconciliation of Borrowings | 1998 £m | 1997 £m |
|---|---|---|
| General business and shareholders (as above) | 1,324 | 1,094 |
| Long-term business | 255 | 260 |
| Total borrowings per note 20 | 1,579 | 1,354 |

| Acquisitions and Disposals of Subsidiary Undertakings | Acquisitions 1998 £m | Disposals 1998 £m | Total 1998 £m | Total 1997 £m |
|---|---|---|---|---|
| Net assets (acquired) disposed of: | | | | |
| Investment in associated undertaking | – | – | – | (43) |
| Goodwill classified as an asset in the balance sheet | (59) | – | (59) | – |
| Net assets held in long-term business operations | (64) | 191 | 127 | (65) |
| Tax payable | – | 38 | 38 | – |
| Other assets | – | – | – | (11) |
| | (123) | 229 | 106 | (119) |
| Goodwill credited (written off) to reserves | – | 28 | 28 | (421) |
| Profit after tax on disposal | – | 211 | 211 | 18 |
| Cash (consideration) proceeds including acquisition and disposal costs | (123) | 468 | 345 | (522) |

## 27 Post Balance Sheet Event

On 11 March 1999, the Company announced the terms of a recommended cash offer for the entire issued and to be issued share capital of M&G Group P.L.C. (M&G), except for those M&G shares which the Prudential Group already owned or which it had contracted to acquire. The offer comprised £25 in cash for each M&G share, with a loan note alternative, and valued the share capital of M&G at approximately £1.9 billion. For the year ended 30 September 1998, M&G reported total revenue of £164 million, profit before tax of £76 million and total equity shareholders' funds of £324 million.

# Report of the Auditors on the Financial Statements

To the members of Prudential Corporation plc

We have audited the financial statements on pages 41 to 63 (including the additional disclosures on pages 34 to 38 relating to the remuneration of directors specified for our review by the London Stock Exchange) which have been prepared in accordance with the accounting policies set out on pages 49 to 51.

## Respective Responsibilities of Directors and Auditors

The directors are responsible for preparing the Annual Report, including as described on page 31 the financial statements. Our responsibilities, as independent auditors, are established by statute, the Auditing Practices Board, the Listing Rules of the London Stock Exchange and our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the Annual Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

We review whether the statement on page 30 reflects the Company's compliance with those provisions of the Combined Code specified for our review by the London Stock Exchange, and we report if it does not. We are not required to form an opinion on the effectiveness of the Company's or Group's corporate governance procedures or its internal controls.

## Basis of Audit Opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

## Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group at 31 December 1998 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers
Chartered Accountants and Registered Auditors
London
18 March 1999

# Five Year Review

| Group Summary | 1998 £m | 1997 £m | 1996 £m | 1995 £m | 1994 £m |
|---|---|---|---|---|---|
| **Results for the year** | | | | | |
| Long-term business (including investment products) | | | | | |
| New business of continuing operations: | | | | | |
| Single | **7,189** | 6,780 | 6,119 | 3,573 | 3,819 |
| Regular | **468** | 487 | 448 | 405 | 477 |
| Premium income: | | | | | |
| Continuing operations | **11,009** | 9,989 | 8,926 | 6,204 | 6,334 |
| Discontinued operations | **456** | 788 | 2,046 | 1,708 | 2,365 |
| General business premiums written: | | | | | |
| Continuing operations | **310** | 306 | 303 | 315 | 333 |
| Discontinued operations | **–** | – | 304 | 292 | 257 |
| Operating profit | | | | | |
| Continuing operations: | | | | | |
| Long-term business | **817** | 740 | 663 | 558 | 452 |
| General business* | **39** | 38 | 69 | 47 | 98 |
| Banking | **(77)** | (22) | (54) | (20) | – |
| Investment management | **43** | 44 | 35 | 32 | 23 |
| Shareholders' investment return* | **189** | 141 | 30 | 56 | 19 |
| Interest payable | **(105)** | (75) | (61) | (68) | (59) |
| Corporate expenditure | **(46)** | (32) | (24) | (22) | (23) |
| Total continuing operations | **860** | 834 | 658 | 583 | 510 |
| Discontinued operations | **8** | 30 | 196 | 215 | 196 |
| Total operating profit (including longer term investment returns)* | **868** | 864 | 854 | 798 | 706 |
| Short-term fluctuations in investment returns* | **24** | 83 | (37) | 215 | (348) |
| Profit on business disposals | **249** | 18 | 797 | 31 | – |
| Reclassification of shareholder reserves of Australian operation | **–** | 204 | – | – | – |
| Total profit on ordinary activities before tax (including actual investment returns) | **1,141** | 1,169 | 1,614 | 1,044 | 358 |
| Profit after tax: | | | | | |
| Operating profit (including post-tax longer term investment returns)* | **654** | 618 | 636 | 543 | 517 |
| Profit for the year (including post-tax actual investment returns) | **880** | 837 | 1,407 | 758 | 222 |
| **Shareholders' Funds and Borrowings** | | | | | |
| Statutory basis capital and reserves: | | | | | |
| Employed in business operations | **2,232** | 1,996 | 1,398 | 2,125 | 1,722 |
| Retained centrally | **2,299** | 1,823 | 2,027 | 352 | 318 |
| | **4,531** | 3,819 | 3,425 | 2,477 | 2,040 |
| Central borrowings | **(1,282)** | (1,036) | (668) | (730) | (777) |
| Total statutory basis capital and reserves | **3,249** | 2,783 | 2,757 | 1,747 | 1,263 |
| Additional achieved profits basis retained profit | **4,261** | 4,129 | 3,816 | 3,856 | 3,375 |
| Achieved profits basis capital and reserves | **7,510** | 6,912 | 6,573 | 5,603 | 4,638 |
| **Funds under Management (£bn)** | **128** | 119 | 91 | 82 | 72 |
| **Share statistics** | | | | | |
| Earnings per share: | | | | | |
| Based on operating profit after tax* | **33.7p** | 32.0p | 33.2p | 28.5p | 27.3p |
| Based on profit for the year after tax | **45.3p** | 43.3p | 73.4p | 39.8p | 11.7p |
| Dividend per share | **21.0p** | 19.1p | 17.3p | 15.7p | 14.4p |
| Market price at 31 December | **908p** | 734p | 492p | 415p | 316p |
| Average number of shares | **1,942m** | 1,932m | 1,917m | 1,905m | 1,896m |

*Operating profits for continuing operations for 1994 to 1997 have been restated from those previously published for the change of treatment of investment returns as explained in note 3 on page 55.

# Five Year Review

| Analysis by Business Area | 1998 £m | 1997 £m | 1996 £m | 1995 £m | 1994 £m |
|---|---|---|---|---|---|
| **UK operations** | | | | | |
| Long-term business | | | | | |
| New business including investment products: | | | | | |
| Single | 4,240 | 3,640 | 3,569 | 2,088 | 2,381 |
| Regular | 361 | 330 | 303 | 280 | 362 |
| Premium income | 7,240 | 5,996 | 5,532 | 3,986 | 4,197 |
| General business premiums written | 310 | 306 | 303 | 315 | 333 |
| Operating profit: | | | | | |
| Long-term business | 393 | 362 | 323 | 306 | 289 |
| General business* | 39 | 38 | 69 | 47 | 98 |
| Investment management | 43 | 44 | 35 | 32 | 23 |
| Banking | (77) | (22) | (54) | (20) | – |
| Total operating profit* | 398 | 422 | 373 | 365 | 410 |
| Statutory basis capital and reserves | 562 | 427 | 259 | 217 | 192 |
| Additional achieved profits basis retained profit | 3,395 | 3,323 | 3,007 | 2,718 | 2,286 |
| Achieved profits basis capital and reserves | 3,957 | 3,750 | 3,266 | 2,935 | 2,478 |
| Assets under management (£bn) | 104 | 93 | 68 | 57 | 48 |
| **Jackson National Life** | | | | | |
| Long-term business | | | | | |
| New business: | | | | | |
| Single | 2,835 | 2,914 | 2,462 | 1,421 | 1,373 |
| Regular | 28 | 37 | 42 | 34 | 46 |
| Premium income | 3,237 | 3,340 | 2,928 | 1,895 | 1,880 |
| Operating profit (including averaged realised gains) | 411 | 367 | 328 | 241 | 154 |
| US GAAP profit (including actual realised gains) | 413 | 377 | 300 | 252 | 128 |
| Statutory basis capital and reserves | 1,547 | 1,300 | 1,017 | 866 | 704 |
| Additional achieved profits basis retained profit | 602 | 546 | 519 | 611 | 590 |
| Achieved profits basis capital and reserves | 2,149 | 1,846 | 1,536 | 1,477 | 1,294 |
| Assets under management (£bn) | 21 | 19 | 16 | 15 | 14 |
| **Prudential Asia** | | | | | |
| Long-term business | | | | | |
| New business: | | | | | |
| Single | 114 | 226 | 88 | 64 | 65 |
| Regular | 79 | 120 | 103 | 91 | 69 |
| Premium income | 532 | 653 | 466 | 323 | 257 |
| Operating profit before development expenses | 23 | 20 | 20 | 16 | 11 |
| Development expenses | (10) | (9) | (8) | (5) | (2) |
| Net operating profit | 13 | 11 | 12 | 11 | 9 |
| Statutory basis capital and reserves | 123 | 46 | 38 | 36 | 18 |
| Additional achieved profits basis retained profit | 255 | 214 | 209 | 177 | 142 |
| Achieved profits basis capital and reserves | 378 | 260 | 247 | 213 | 160 |
| Assets under management (£bn) | 1.7 | 1.5 | 1.5 | 1.4 | 1.0 |

# Achieved Profits Basis Supplementary Information
# Operating Profit from Continuing Operations

| Results Analysis by Business Area | 1998 £m | 1997 £m |
|---|---|---|
| **UK operations** | | |
| Long-term business | | |
| New business | **220** | 208 |
| Business in force | **294** | 362 |
| Total long-term business | **514** | 570 |
| General business | **39** | 38* |
| Investment management | **43** | 44 |
| Banking | **(77)** | (22) |
| **Total** | **519** | 630* |
| **Jackson National Life** | | |
| New business | **137** | 140 |
| Business in force | **231** | 250 |
| **Total** | **368** | 390 |
| **Prudential Asia** | | |
| Long-term business | | |
| New business | **56** | 62 |
| Business in force | **27** | 29 |
| Total long-term business | **83** | 91 |
| Development expenses | **(10)** | (9) |
| **Total** | **73** | 82 |
| **Shareholders' other income** | | |
| Investment return | **202** | 141* |
| Corporate expenditure | **(46)** | (32) |
| Interest payable | **(105)** | (75) |
| **Total** | **51** | 34* |
| **Total continuing operations** | **1,011** | 1,136* |

*Restated for altered basis of recognition of investment returns, as explained in note 4(ii) on pages 71 and 72.

# Review of Results

On the achieved profits basis of reporting, Group operating profit before tax was £1,023 million in 1998 of which £955 million was contributed by continuing long-term business operations.

Profit from new business held steady at £413 million despite adverse trading conditions in most of our main markets. Profit from business in force at £542 million was held back by the impact of provisions for pension mis-selling in the UK and strengthened economic assumptions in the Group's UK and North American operations. Excluding the effects of these changes, profit from business in force increased by some ten per cent.

# Review of Results

## UK Operations

The long-term business result for the Group's UK operations fell ten per cent to £514 million, reflecting the reduction from nine per cent to eight per cent in the rate of the expected long-term investment return credited to operating results and a charge of £84 million in respect of the increase in provision for pension mis-selling to £1.1 billion announced at the 1998 interim results.

Weighted insurance premium growth in the UK was 25 per cent. However, the achieved profits contribution from new business was only marginally ahead of 1997 at £220 million due to a combination of altered sales mix, exceptional levels of investment spend, and the reduction in expected future investment returns.

## Jackson National Life

At Jackson National Life operating profit fell by six per cent to £368 million following a £53 million one-off charge for strengthened persistency assumptions. This change, together with a reduction in the discount rate from ten per cent to 8.5 per cent, reflects the lower interest rate environment in the United States.

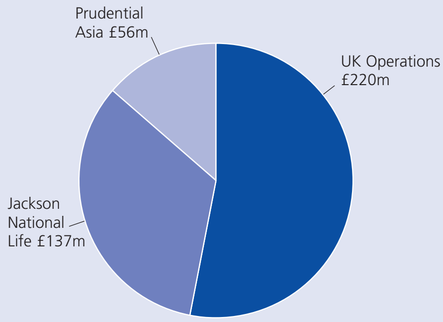
Contributions from new business fell by two per cent to £137 million, broadly in line with sales volumes. Excluding the effects of altered assumptions, underlying profit from business in force was some nine per cent higher than for 1997.

## Prudential Asia

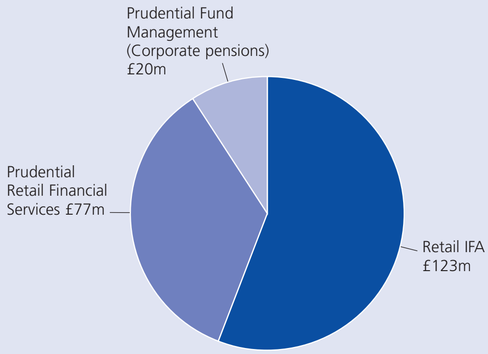
Despite considerable economic turmoil in the region, profit from Prudential Asia fell by only £9 million to £73 million. Although weighted premiums fell by some 40 per cent, profit from new business was down just ten per cent on 1997 reflecting primarily a shift in sales towards higher margin linked and non-participating business.

## Shareholders' Funds

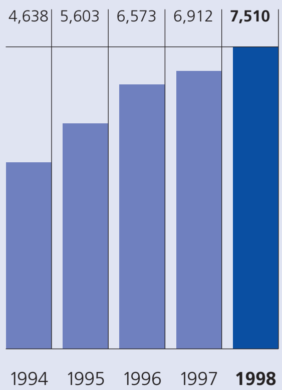
Total achieved profits basis shareholders' funds increased by nine per cent to £7.5 billion. The increase demonstrates the retention of operating profit within the Group's long-term businesses, investment returns substantially in excess of the expected long-term trend, and the gain on sale following the disposal of the Group's Australasian operations, partly offset by the impact of changes in economic assumptions.




**1998 Profit from New Business – Continuing Operations by Business Area (£m)**




**1998 Profit from New Business – UK Operations by Business Area (£m)**




**Total Achieved Profits Basis – Shareholders' Funds (£m)**

# Summarised Consolidated Profit and Loss Account – Achieved Profits Basis

Year ended 31 December 1998

| | 1998 £m | 1997 £m |
|---|---|---|
| Operating profit (including investment returns based on long-term rates of investment return) | | |
| Continuing operations: | | |
| Long-term business | | |
| New business | 413 | 410 |
| Business in force | 542 | 632 |
| Total long-term business | 955 | 1,042 |
| General business | 39 | 38* |
| Banking | (77) | (22) |
| Other activities (including interest payable) | 94 | 78* |
| **Total continuing operations** | 1,011 | 1,136* |
| Discontinued operations | 12 | 31 |
| **Total operating profit** | 1,023 | 1,167* |
| Short-term fluctuations in investment returns | 289 | 538* |
| Net loss from changes to UK projected long-term rate of investment return and UK and US risk discount rates (notes 2(ii) and 3) | (106) | (184) |
| Profit on business disposals | 202 | – |
| Reclassification of shareholder reserves of Australian operation | – | 187 |
| **Profit on ordinary activities before tax (including actual investment gains)** | 1,408 | 1,708 |
| Tax | (371) | (519) |
| **Profit for the financial year** | 1,037 | 1,189 |
| Dividends | (407) | (370) |
| **Retained profit for the financial year** | 630 | 819 |

# Earnings per Share – Achieved Profits Basis

Year ended 31 December 1998

| | 1998 | 1997 |
|---|---|---|
| Operating profit after tax | £752m | £811m* |
| Operating earnings per share | 38.7p | 42.0p* |
| Total profit after tax | £1,037m | £1,189m |
| Total earnings per share | 53.4p | 61.5p |
| Average number of shares | 1,942m | 1,932m |

# Statement of Total Recognised Gains and Losses – Achieved Profits Basis

Year ended 31 December 1998

| | 1998 £m | 1997 £m |
|---|---|---|
| **Profit for the financial year** | 1,037 | 1,189 |
| Exchange movements | (75) | (64) |
| **Total recognised gains** | 962 | 1,125 |

*Restated for altered basis of recognition of investment returns, as explained in note 4(ii) on pages 71 and 72.

# Summarised Consolidated Balance Sheet – Achieved Profits Basis

31 December 1998

| | 1998 £m | 1997 £m |
|---|---|---|
| Investments | 100,394 | 91,719 |
| Other assets | 18,218 | 16,504 |
| Total assets | 118,612 | 108,223 |
| Less liabilities | (7,051) | (5,575) |
| **Total assets less liabilities** | 111,561 | 102,648 |
| **Less insurance funds** | | |
| Technical provisions | 87,433 | 80,564 |
| Fund for future appropriations | 20,879 | 19,301 |
| Less shareholders' accrued interest in the long-term business | (4,261) | (4,129) |
| | 104,051 | 95,736 |
| **Achieved profits basis net assets** | 7,510 | 6,912 |
| **Shareholders' capital and reserves** | | |
| Share capital and share premium | 319 | 254 |
| Statutory basis retained profit | 2,930 | 2,529 |
| Additional achieved profits basis retained profit | 4,261 | 4,129 |
| **Achieved profits basis capital and reserves** | 7,510 | 6,912 |

# Reconciliation of Movement in Shareholders' Capital and Reserves – Achieved Profits Basis

Year ended 31 December 1998

| | 1998 £m | 1997 £m |
|---|---|---|
| **Total recognised gains** | 962 | 1,125 |
| Goodwill reversed on disposals (charged on acquisitions): | | |
| Statutory basis | 28 | (442) |
| Additional charge in respect of life fund consideration for Scottish Amicable | – | (18) |
| New share capital subscribed | 15 | 44 |
| Dividends | (407) | (370) |
| Net increase in shareholders' capital and reserves | 598 | 339 |
| Shareholders' capital and reserves at beginning of year | 6,912 | 6,573 |
| **Shareholders' capital and reserves at end of year** | 7,510 | 6,912 |
| **Comprising:** | | |
| UK operations | 3,957 | 3,750 |
| Jackson National Life | 2,149 | 1,846 |
| Prudential Asia | 378 | 260 |
| Other operations | 1,026 | 787 |
| Discontinued operations | – | 269 |
| **Shareholders' capital and reserves at end of year** | 7,510 | 6,912 |

# Notes on the Achieved Profits Basis Supplementary Information

## 1 Basis of Preparation

The achieved profits basis results have been prepared in accordance with the draft 'Guidance on accounting in Group Accounts for proprietary companies' long-term insurance business' issued by the Association of British Insurers in July 1995. The information is supplementary to the financial statements on pages 41 to 63.

In preparing the results, the Group has been advised by Tillinghast, consulting actuaries.

## 2 Assumptions

*(i) Methodology*

The achieved profits basis results incorporate best estimate forecasts of future rates of investment return, proprietor's spread (in the case of Jackson National Life), policy discontinuancies, mortality, expenses, expense inflation, taxation, bonus rates, surrender and paid up bases, and statutory valuation bases. In preparing these forecasts, account has been taken of recent experience and general economic conditions together with inherent uncertainty. It has been assumed that the bases and rates of taxation, both direct and indirect, will not change materially in the countries in which the Group operates.

The proportion of surplus allocated to shareholders from the UK with-profits business has been based on the present level of ten per cent. Future bonus rates have been set at levels which would fully utilise the assets of the with-profits fund over the lifetime of the business in force. In the UK, Department of Social Security rebate business has been treated as single premium business.

With the exception of the expected future rate of investment return for the UK with-profits fund and related discount rate, and assumptions for surrender rates and discount rate in Jackson National Life, the results for 1998 and 1997 have been prepared using the same principal assumptions.

*(ii) Expected rates of future investment return and spread assumptions*

Expected future rates of investment return reflect prevailing interest rates, the outlook for inflation and the mix of the investment portfolio. In determining the 1997 results for UK operations, the gross of tax expected future rate of investment return was taken as nine per cent. For 1998, following a revision to inflationary expectations, the expected future rate of investment return for the UK with-profits fund has been reduced to eight per cent.

For Jackson National Life, the absolute level of rates of future return is less important than the spread achieved between the earned rate and the rates credited to policyholders. In determining the results for both 1998 and 1997, a spread of 1.90 per cent for the main single premium deferred annuity product has been assumed.

Management charges on unit linked business have been projected from smoothed unit prices.

## 3 Discount Rates

The shareholders' interests in the future net of tax cash flows of the long-term businesses have been discounted to present values using the following discount rates:

| | 1998 | 1997 |
|---|---|---|
| UK operations | **8.5%** | 9.5% |
| Jackson National Life | **8.5%** | 10.0% |

These discount rates represent the best estimate of the shareholders' long-term risk free rate of return on appropriate government securities plus a margin to allow for adverse fluctuations and the risks borne.

The unwind of the discount rate on the present value of future statutory profits is included in profit from business in force.

## 4 Investment Return

*(i) Profit before tax*

With the exception of fixed interest investments held by Jackson National Life, investment gains during the period (to the extent that changes in capital values do not directly match changes in liabilities) are included in the profit for the year and shareholders' funds as they arise.

In the case of Jackson National Life, it is assumed that fixed income investments will normally be held until maturity. Therefore unrealised gains are not reflected in either the achieved profits or statutory basis results and, except on realisation of investments, only income received and the amortisation of the difference between cost and maturity values are recognised to the extent attributable to shareholders.

*(ii) Operating profit*

Except for Jackson National Life, investment returns, including investment gains, in respect of long-term insurance business are recognised in operating results at the expected long-term rate of return. For the purposes of calculating investment return to be

# Notes on the Achieved Profits Basis Supplementary Information

recognised in operating results, values of assets at the beginning of the reporting period, to which the expected long-term rates of return are applied, are adjusted to be consistent with long-term expected income yields. This adjustment is most significant for the results of the UK operations.

For Jackson National Life some investments are realised before maturity, mainly through early redemption by issuers or mortgage holders. Gains made on realisation are spread forward over five years for the purposes of calculating operating results.

Consistent with the change of method for recognition of investment returns explained in note 3 on page 55 the basis for crediting investment returns to operating profit for general insurance and shareholders' funds has been altered. The effect of the change is as follows:

| | 1998 £m | 1997 £m |
|---|---|---|
| Total operating profit before tax | | |
| Before change | **1,048** | 1,198 |
| After change | **1,023** | 1,167 |
| Total operating profit after tax | | |
| Before change | **771** | 837 |
| After change | **752** | 811 |
| Operating earnings per share | | |
| Before change | **39.7p** | 43.3p |
| After change | **38.7p** | 42.0p |

Comparative results for 1997 have been restated for the change of method. The change has no effect on total profit before or after tax.

## 5 Tax

The profit for the year is in most cases calculated initially at the post-tax level. The post-tax profit is then grossed up for presentation purposes at the effective rates of tax applicable to the countries and periods concerned. For UK operations the effective rate has been taken as the full rate of Corporation Tax for the year concerned. For Jackson National Life the profit is calculated at the pre-tax level and the effective tax rate is that expected to be applicable on average over the remaining lifetime of the policies.

## 6 Foreign Currency Translation

Foreign currency revenue has been translated at average exchange rates for the year. Foreign currency assets and liabilities have been translated at year end rates of exchange.

## 7 Cost of Capital

On the achieved profits basis, a charge is deducted from the annual result and the balance sheet value for the cost of capital supporting solvency requirements of the Group's long-term business. This cost is the difference between the nominal value of solvency capital and the present value, at risk discount rates, of the projected release of this capital and investment earnings on the capital.

The annual result is impacted by the movement in this cost from year to year which comprises a charge against new business profit with a partial offset for the release of capital requirements for business in force.

Where solvency 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 release over time and no further adjustment is necessary in respect of solvency capital.

However, where business is funded directly by shareholders, principally at Jackson National Life, the solvency capital requires adjustment to reflect the cost of that capital.

In determining the cost of capital of Jackson National Life, it has been assumed that an amount equal to 200 per cent of the risk based capital required by the US supervisory authorities must be retained. The impact on Jackson National Life's shareholders' funds of the related capital charge is as follows:

| | 1998 £m | 1997 £m |
|---|---|---|
| Before capital charge | **2,382** | 2,118 |
| Capital charge | **(233)** | (272) |
| After capital charge | **2,149** | 1,846 |

# The Achieved Profits Basis of Financial Reporting

The achieved profits basis of financial reporting is based on conventional accounting principles and recognises profit as it accrues over the life of an insurance contract. Although total profit from each contract calculated under this method is the same as under the modified statutory basis of reporting used for the main accounts, the timing of recognition of profit is advanced.

The achieved profits basis can be illustrated by considering an individual contract. Using prudent best estimate assumptions of the main elements of future income and expenditure – investment return, claims, lapses, surrenders and administration expenses – the total profit expected to be earned from the contract can be estimated at the time of its sale. The total profit expected to be earned is then allocated to individual financial years by application of a discount rate which allows for both the time value of money and the risks associated with the future shareholder cash flows.

Provided that the actual outcome is in line with the original assumptions, profits will be earned in each accounting period as the discount rate unwinds. The balance of profit not allocated to future years is recognised in the year of sale and is known as the profit from new business. The unwind of the discount rate and variances between actual and assumed experience during the remainder of the contract period produce the profit on business in force.

The additional profits recognised at an earlier stage under the achieved profits method are retained within the long-term funds and are known as the shareholders' accrued interest in the long-term business.

The achieved profits basis is designed to report profits which reflect business performance during the year under review, particularly new business sales and fluctuations between actual and assumed experience.

The use of the achieved profits basis does not affect either the cash surpluses which are released to shareholders' funds from the long-term funds, which continue to be determined by the directors following statutory actuarial valuations of the funds, or amounts available for dividend payments to shareholders.

The additional profit recognised using the achieved profits basis is represented by the shareholders' accrued interest in the long-term business and, when combined with shareholders' funds reported on the statutory basis, provides an improved measure of total shareholders' funds of the Group.

# Report of the Auditors on the Achieved Profits Basis Supplementary Information

to the members of Prudential Corporation plc

We have audited the supplementary information on pages 69 to 72, which has been prepared on the basis set out in note 1 on page 71 and is limited to a restatement of the Group profit and the shareholders' interest in the Group's long-term business on an achieved profits basis.

## Respective Responsibilities of Directors and Auditors

The Company's directors are responsible for the preparation of the Annual Report including as described on page 31 the financial statements and supplementary information. Our responsibilities are outlined on page 64.

## Basis of Opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the supplementary information. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the supplementary information and of whether the accounting policies are appropriate to the circumstances of the Group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the supplementary information stated on the achieved profits basis is free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of the supplementary information.

## Opinion

In our opinion, the achieved profits basis Group profit for the year ended 31 December 1998 and shareholders' interest in the long-term business at that date have been properly prepared in accordance with the methodology and disclosure requirements contained in the draft 'Guidance on accounting in Group Accounts for proprietary companies' long-term insurance business' issued by the Association of British Insurers in July 1995.

PricewaterhouseCoopers
Chartered Accountants
London
18 March 1999

# Shareholder Information

| | |
|---|---|
| Annual General Meeting | 6 May 1999 |
| Payment of 1998 final dividend | 26 May 1999 |
| Announcement of 1999 interim results | 29 July 1999 |
| Ex-dividend date for 1999 interim dividend | 20 September 1999 |
| Payment of 1999 interim dividend | 25 November 1999 |

# Analysis of Registered Shareholder Accounts at 31 December 1998

| Size of shareholding | Number of shareholders | % | Number of shares | % |
|---|---|---|---|---|
| Over 10,000,000 | 26 | | 690,656,883 | 35 |
| 1,000,001 – 10,000,000 | 241 | 1 | 731,303,367 | 38 |
| 500,001 – 1,000,000 | 157 | | 111,680,125 | 6 |
| 100,001 – 500,000 | 671 | 1 | 152,104,022 | 8 |
| 50,001 – 100,000 | 525 | 1 | 37,999,592 | 2 |
| 10,001 – 50,000 | 4,065 | 5 | 79,489,123 | 4 |
| 5,001 – 10,000 | 6,290 | 8 | 44,411,525 | 2 |
| 1,001 – 5,000 | 35,946 | 44 | 82,772,192 | 4 |
| 1 – 1,000 | 32,284 | 40 | 18,249,341 | 1 |
| **Total** | **80,205** | **100** | **1,948,666,170** | **100** |

# Sharedealing Facilities

Stockbrokers Cazenove & Co offer a postal sharedealing service to Prudential shareholders at competitive commission rates. For details telephone 0171 588 2828 or write to 12 Tokenhouse Yard, London, EC2R 7AN.

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