PRUDENTIAL

**Prudential plc**

**英國保誠有限公司***

*(Incorporated and registered in England and Wales under the number 01397169)*

**(Stock code: 2378)**

# PRESS RELEASE AND ANNOUNCEMENT OF ANNUAL RESULTS FOR THE YEAR ENDED 31 DECEMBER 2010

* *For identification purpose*

# NEWS RELEASE

PRUDENTIAL

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9 March 2011

**PRUDENTIAL PLC FULL YEAR 2010 RESULTS**

**PRUDENTIAL CONTINUES TO DELIVER STRONG RESULTS**

**New Business:**
- Total APE sales[1] of £3,485 million up 23 per cent
- EEV new business profit margin (% APE) of 58 per cent
- EEV new business profit[1] of £2,028 million up 25 per cent
- Investment in new business[1] of £643 million (2009: £660 million)

**IFRS:**
- Operating profit of £1,941 million up 24 per cent
- Profit for the year after tax of £1,431 million up 112 per cent
- Shareholders' funds of £8.0 billion up 28 per cent

**Embedded Value:**
- Operating profit of £3,696 million up 20 per cent
- Shareholders' funds of £18.2 billion, up 19 per cent, equivalent to 715 pence per share

**Capital & Dividend:**
- Insurance Groups Directive ('IGD') capital surplus estimated at £4.3 billion
- Underlying free surplus generation up 21 per cent to £1,714 million
- 2010 full year dividend increased by 20 per cent to 23.85 pence per share

Commenting on the results, Tidjane Thiam, Group Chief Executive, said:

"We have achieved a strong performance in 2010, with results significantly ahead on all key measures. Our disciplined approach to capital allocation, proactive risk management and focus on profitability are generating both growth and cash for our shareholders.

"These principles have served us well during the financial crisis, allowing us to emerge from the 2008–2009 period with a stronger balance sheet, higher profits, higher cash flows and an increased dividend. Each part of the Group plays a key role in our strategy. Our flexibility and diversification have been instrumental in allowing us to navigate successfully the economic and market cycle. We have set ourselves ambitious objectives for cash generation not only from Asia but also from other parts of the Group.

"The quality of our strategic options, our discipline in putting value ahead of volume and our focus on execution should allow us to continue to grow profitably and to generate significant returns for our shareholders. This is evidenced by the upwards rebasing of the dividend that we have announced today."

[1] Excluding Japan which ceased writing new business in 2010.

**Contact:**


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**Notes to Editors:**

1. The results in this announcement are prepared on two bases: International Financial Reporting Standards ('IFRS') and European Embedded Value ('EEV'). The IFRS basis results form the basis of the Group's statutory financial statements. The supplementary EEV basis results have been prepared in accordance with the European Embedded Value Principles issued by the CFO Forum of European Insurance Companies in May 2004. Where appropriate the EEV basis results include the effects of IFRS. Period on period percentage increases are stated on an actual exchange rate basis.

2. Asia 2010 and 2009 comparative APE new business sales, new business profit (NBP) and investment in new business exclude the Japanese insurance operations which we have closed to new business with effect from 15 February 2010 and 2009 comparatives exclude the Taiwan agency business disposed of during the second quarter of 2009.

3. Annual premium equivalent (APE) sales comprise regular premium sales plus one-tenth of single premium insurance sales.

4. Operating profits are determined on the basis of including longer-term investment returns. EEV and IFRS operating profits are stated after excluding the effect of short-term fluctuations in investment returns against long-term assumptions, the shareholders' share of actuarial and other gains and losses on defined benefit pension schemes, costs associated with the terminated AIA transaction, and the gain arising upon the dilution of the Group's holding in PruHealth. Consistent with the prior year presentation the effect of disposal and results of the Taiwan agency business are shown separately. In addition for EEV basis results, operating profit excludes the effect of changes in economic assumptions and the mark to market value movement on core borrowings.

5. In 2010, the Group amended the presentation of IFRS operating profit for its US insurance operations to remove the net equity hedge accounting effect (incorporating related amortisation of deferred acquisition costs) and include it in short term fluctuations. Prior year comparatives have been amended accordingly. This is a presentational change and it has no impact on the IFRS profit before tax or the IFRS shareholders' funds. The change also has no impact on our EEV financial statements.

6. There will be a conference call today for wire services at 09.00am GMT hosted by Tidjane Thiam, Group Chief Executive. Dial in telephone number: +44 (0)20 3140 0668. Passcode: 7193929#.

7. A presentation to analysts will be webcast live at 10.30am GMT from the London Stock Exchange 10 Paternoster Square, London, EC4M 7LS. This can be viewed live, and as a replay, on the corporate website via the link below.
   http://www.prudential.co.uk/prudential-plc/investors/resultspresentations/resultsday/
   Alternatively, a dial-in facility will be available to listen to the presentation: Please allow time ahead of the presentation to join the call (lines open half an hour before the presentation is due to start, i.e. from 10.00 GMT). Dial in: +44 (0)20 8817 9301 Passcode: 4407994#. Playback: +44 (0)20 7769 6425, Passcode, 4407994#. This will be available for approximately 13.30 (GMT) on 9 March 2011 until 23.59 (GMT) on 16 March 2011.

8. High resolution photographs are available to the media free of charge at www.newscast.co.uk on +44 (0) 20 3137 9137 or by calling Prudential press office on +44 (0)20 7548 2466.

9. Total number of Prudential plc shares in issue as at 31 December 2010 was 2,545,594,506.

10. **Financial Calendar 2011**:

| | |
|---|---|
| First Quarter 2011 Interim Management Statement | 27 April 2011 |
| AGM | 19 May 2011 |
| 2011 Half Year Results | 2 August 2011 |
| Third Quarter 2011 Interim Management Statement | 8 November 2011 |

**2010 Full Year Dividend**

| | |
|---|---|
| Ex-dividend date | 30 March 2011 (UK, Irish and Singapore shareholders)<br>31 March 2011 (Hong Kong shareholders) |
| Record date | 1 April 2011 |
| Payment of dividend | 26 May 2011 (UK, Irish and Hong Kong shareholders)<br>On or about 2 June 2011 (Singapore shareholders) |

11. **About Prudential plc**
Prudential plc is a company incorporated and with its principal place of business in England, and its affiliated companies constitute one of the world's leading financial services groups. It provides insurance and financial services through its subsidiaries and affiliates throughout the world. It has been in existence for over 160 years and has £340 billion in assets under management (as at 31 December 2010). Prudential plc is not affiliated in any manner with Prudential Financial, Inc, a company whose principal place of business is in the United States of America.

12. **Forward-Looking Statements**
This statement may contain certain "forward-looking statements" with respect to certain of Prudential's plans and its current goals and expectations relating to its future financial condition, performance, results, strategy and objectives. Statements that are not historical facts, including statements about our beliefs and expectations, are forward-looking statements. These statements are based on current plans, estimates and projections, and therefore you should not place undue reliance on them. By their nature, all forward-looking statements involve risk and uncertainty. A number of important factors could cause Prudential's actual future financial condition or performance or other indicated results to differ materially from those indicated in any forward-looking statement. Such factors include, but are not limited to, future market conditions, fluctuations in interest rates and exchange rates, and the performance of financial markets generally; the policies and actions of regulatory authorities, including, for example, new government initiatives related to the financial crisis and the effect of the European Union's "Solvency II" requirements on Prudential's capital maintenance requirements; the impact of competition, inflation, and deflation; experience in particular with regard to mortality and morbidity trends, lapse rates and policy renewal rates; the timing, impact and other uncertainties of future acquisitions or combinations within relevant industries; the impact of changes in capital, solvency standards or accounting standards, and tax and other legislation and regulations in the jurisdictions in which Prudential and its affiliates operate; and the impact of legal actions and disputes. These and other important factors may for example result in changes to assumptions used for determining results of operations or re-estimations of reserves for future policy benefits. Further discussion of these and other important factors that could cause Prudential's actual future financial condition or performance or other indicated results to differ, possibly materially, from those anticipated in Prudential's forward-looking statements can be found under the heading "Risk factors" in Prudential's most recent Annual Report and in Item 3 "Risk Factors" of Prudential's most recent annual report on Form 20-F filed with the U.S. Securities and Exchange Commission, as well as under the heading "Risk factors" in any subsequent Prudential Half Year Financial Report. Prudential's most recent Annual Report and any subsequent Half Year Financial Report are available on its website at www.prudential.co.uk.

Any forward-looking statements contained in this statement are made only as of the date hereof. Prudential undertakes no obligation to update the forward-looking statements contained in this statement or any other forward-looking statements it may make, whether as a result of future events, new information or otherwise except as required pursuant to the Prospectus Rules, the Listing Rules, the Disclosure and Transparency Rules, the Hong Kong Listing Rules or the SGX-ST listing rules.

## 2010 Full Year Results Group Chief Executive's report

I am pleased to report a very strong performance in 2010, with results significantly ahead of 2009. We achieved this by remaining focused on rigorous capital allocation and effective management of our balance sheet.

These principles have served us well during the financial crisis allowing us to emerge from the 2008–2009 period with a stronger balance sheet, higher profits, higher cash flows and an increased dividend. Our 2010 results confirm that our strategy, underpinned by our operating principles, should increasingly allow us to differentiate ourselves through our ability to combine growth and cash generation, as we announced at our Investor Day on 1 December 2010.

### Our strategy

At the centre of our strategy is the acceleration of our profitable growth in Asia, which offers many of the highest growth and return opportunities. The emerging markets of South-East Asia – such as Indonesia, Malaysia, Vietnam, the Philippines and Thailand, together with Hong Kong and Singapore – are particularly attractive. They remain the priority destination for our new capital investment. With our compelling platform of distribution, brand and product development capabilities in the high growth markets of Asia, we believe we are particularly well positioned to take advantage of the considerable opportunity that the region offers.

In the US, we continue to build on the strength of our operations to make them a more significant component of the Group in terms of IFRS earnings as well as cash generation. In the UK, we remain focused on generating cash and capital and providing resilience to the Group's balance sheet.

In asset management, our strong track record, both at M&G and in our asset management business in Asia, is enabling us to grow our funds under management. These businesses make an increasingly important contribution to our profits and cash generation.

Each part of the Group plays a key role in our strategy. Our flexibility and diversification were instrumental in allowing us to navigate successfully the economic and market cycle in 2008 and 2009.

In executing this strategy, we are guided by three clearly-defined Group wide operating principles. The first of these is that from 2008, we decided to take a more balanced approach to performance management across the three key measures of Embedded Value (EEV), IFRS and cash, with an increased emphasis on IFRS and cash. When this operating principle was introduced, it was a clear break with how our industry, and our company, had operated previously. As a consequence of this new focus, we have been able in 2010, for the third year in a row, to report results that are in fast progression across all three key measures – EEV, IFRS and cash.

Second, we have focused on allocating capital with total discipline to the highest return and shortest payback opportunities across the Group. This means that we restrict new business to areas of the market where these stringent criteria are met. As a result, we have not hesitated to take and implement a number of challenging decisions. Even in our preferred region of Asia, we acted decisively when necessary for the Group, as illustrated by our decision to sell our back book of business in Taiwan, to curtail writing new life business in Japan, or exchange short-term sales volume in Korea for long-term shareholder value. In the UK, we have closed down the equity release business and significantly increased our minimum return criteria for bulk purchase annuities. In the US, we have managed our sales of annuities, fixed and variable, with a clear focus on returns and payback periods, not hesitating to lose market share when necessary and putting value ahead of volume.

Finally, our third operating principle – of equal importance – is to take a proactive approach to managing risk across the cycle. We have transformed the capital position of the Group during the last three years, closing 2010 with more than £4 billion of IGD capital surplus against £1.5 billion at the end of 2008. We have significantly more capital today than before the financial crisis, and we have put in place a set of processes to hedge and manage the key risks to which we are exposed.

Our strategy and the disciplined implementation of our operating principles have produced excellent results.

**Group performance**

In 2010, APE sales[1] were up 23 per cent in life insurance to £3,485 million (2009: £2,844 million) and new business profit[1] has increased by 25 per cent to £2,028 million (2009: £1,619 million) as our new business margins increased to 58 per cent (2009: 57 per cent).

Net inflows in our asset management businesses were £8.9 billion, following an exceptional year in 2009 (2009: £15.4 billion). These continued strong inflows underpin the robust performance of our asset management operations during the year and are a direct driver of the growth in our profits.

On the statutory IFRS basis, our operating profit before tax from continuing operations increased by 24 per cent in 2010 to £1,941 million (2009: £1,564 million). IFRS profit for the year after tax increased by 112 per cent to £1,431 million (2009: £676 million). IFRS shareholder funds increased 28 per cent in 2010 to £8.0 billion (2009: £6.3 billion).

On the EEV basis, Group operating profit before tax increased by 20 per cent in 2010 to £3,696 million (2009: £3,090 million). New business profit[1] for the year was £2,028 million, an increase of 25 per cent (2009: £1,619 million), and we continued to deliver very strong margins of 58 per cent (2009: 57 per cent). Our total investment in new business[1] in 2010 was £643 million (2009: £660 million), a reduction of 3 per cent. As a result of our focus on rigorous capital allocation, we are delivering higher returns on capital invested for our shareholders, while managing to use less capital in absolute terms.

Since 2008, we have been using free surplus as the primary indicator of our ability to generate cash and capital. In 2010, free surplus increased 32 per cent to £3.3 billion, up from £2.5 billion at the end of 2009 and £0.9 billion at the end of 2008.

As these results show, we achieved strong growth on our three key metrics of EEV, IFRS and cash simultaneously. From 2009 to 2010, both our IFRS and EEV operating profits have grown by 20 per cent or more, while consuming less capital in absolute terms.

Our ability to generate significant growth while providing increasing cash returns to our shareholders – 'growth and cash' – is the result of our differentiated strategy. This strategy and the quality of our teams, both in our business units and our head office, allow us to provide value to our customers and shareholders. Each of our businesses is a clear leader in its market.

A year ago, we announced an agreement with AIG to acquire its Asia operations, AIA. The proposed acquisition was a unique opportunity to accelerate our strategy of focusing on the fast growing markets in Asia. We could not agree a purchase price that was acceptable to the AIG Board. The costs associated with the transaction were announced at our half year results and are detailed in the full year results statement.

[1] Excluding Japan, which ceased writing new business in 2010.

## Our operating performance by business unit

Our aim across all our businesses is to develop and market a suite of products that deliver good value solutions that meet our customers' needs, in a way that is profitable and capital efficient for the Group.

*Prudential Corporation Asia*

In 2010, in line with our strategy, our core investment was in the fast growing and highly profitable markets of South-East Asia and Hong Kong and Singapore. Due to the long-term structural changes taking place in these economies, we continue to believe they offer the most attractive opportunity in the global life insurance market today.

Distribution remains critical to our business in Asia, and our unique combination of proprietary agency distribution and bank partnerships continues to deliver excellent results. Agency will remain the dominant and most profitable channel in Asia for many years to come. It is clear that Prudential's agency distribution platform compares favourably to our peer group, whether in terms of scale, training or productivity. In addition, we will continue developing our presence in the bancassurance channel. The performance of our new partnership with UOB reinforces our view that the bancassurance channel will be increasingly important as Asian middle classes become wealthier and increasingly use banks and their services. This, together with our strategy of growing health and protection business, has been central to increasing our profitability and margins.

Our financial performance in Asia will continue to be based on three principal drivers. First, as a result of our strong new business growth, and its contribution to the increase in our in-force policies book, net inflows will be a major contributor to our IFRS earnings. Second, there will continue to be a contribution from investment returns, which will increase as the business grows. Third, as the scale of the business increases, our profitability will continue to benefit from the efficiency of our Asian platform, with revenues growing faster than our cost base. These three drivers support our confidence in our ability to double our 2009 IFRS profits by 2013.

*Jackson National Life*

In the US, we have maintained our focus on value over sales volume growth, ensuring sales are delivered at highly profitable margin levels. We have maintained our pricing discipline and have been consistent in our approach of not chasing market share for its own sake. In 2010 we continued to benefit from the market changes following the financial turmoil in 2008 and 2009. As part of a trend, mostly driven by distributors who guide their customers towards the companies that held firm through the crisis and never closed to business, Jackson has significantly improved its position in the key variable annuity market. This flight to quality has allowed the Jackson team to increase sales volumes and market share. Our consistent pricing approach, product flexibility and Jackson's strong credit rating, which has remained unchanged for eight years, have served us well.

We have continued to grow the number of advisers appointed to sell our products, increasing licensed agents and registered representatives in 2010 by 34 per cent to more than 130,000.

*Prudential UK*

Our business in the UK is highly disciplined and generates differentiated returns relative to the market. We continued to be a market leader in both individual annuities and with-profits business. We maintained our focus on balancing the writing of new business with the generation of cash and capital, successfully delivering attractive returns on capital employed. This strategy led the UK to deliver net cash of £420 million to the Group in 2010.

Our emphasis on value and generating strong returns saw the UK business continue to prioritise the retail market, while selectively participating in the wholesale market. Wholesale market opportunities have only been pursued when they meet our strict financial criteria and deliver an appropriate return on the capital invested both in terms of quantum but also, and equally important, of payback period. In 2010 we also continued to make good progress against our cost reduction plans, meeting our 2010 savings target of £195 million per annum six months early.

*Asset management*
M&G had a very good 2010, a performance which is all the more impressive as it comes after an exceptional year in 2009. M&G continues to focus on offering customers superior investment performance over the longer term, building on its proven track record of success in the retail investment market through ongoing expansion in Europe. M&G's retail business achieved net inflows of £7.4 billion. M&G's IFRS operating profit was £284 million, up 19 per cent compared to 2009.

In Asia, our asset management business also had a very successful year, with operating profits of £72 million, 31 per cent ahead of 2009. It is a key feature of our strategy that asset management profits are very capital efficient and are 'cash rich' profits. For the first time, funds under management passed the £50 billion mark, up from £42.4 billion in 2009, a trend that should also lead to continued profit growth.

These achievements underline the potential we see for asset management across Asia. We continue to believe that this is one of the most exciting opportunities for the Group today. In 2010, we appointed a new Chief Executive, and we are determined to continue to invest to capture a significant share of the growth and profits available in asset management in Asia. The priorities for our asset management business in Asia are: to build and develop institutional relationships, securing pan-Asia discretionary mandates; to increase our focus on Japan and China, as the region's largest and fastest growing markets respectively; and, finally, to grow our offshore funds business.

**Capital and risk management**
A strong capital position is key to our development. It gives confidence to our customers in what is a long-term business, and it allows us to write large amounts of new business. Strict management and allocation of capital remain a core focus for our Group. Using the regulatory measure of the Insurance Groups Directive (IGD), our Group capital surplus at 31 December 2010 was estimated at £4.3 billion (31 December 2009: £3.4 billion). The Group's required capital is covered 3.0 times. This ratio means we continue to be one of the world's best-capitalised insurers.

We have strengthened our risk management practices by forming a Group Risk Committee headed by Howard Davies reporting directly to the Board. We also appointed a new Chief Risk Officer (CRO), John Foley, and have elevated the CRO position to board level.

**Dividend**

In view of the progress that the Group has made in recent years to improve IFRS operating profitability and free surplus generation, the Board has decided to rebase the full year dividend upwards by 4 pence per share, equivalent to an increase of 20 per cent. In line with this, the directors recommend a final dividend of 17.24 pence per share, which brings the total dividend for the year to 23.85 pence per share (2009: 19.85 pence per share).

The scrip dividend scheme is not being offered in respect of this dividend. In its place shareholders will be offered a Dividend Reinvestment Plan ('DRIP').

The Board will maintain its focus on delivering a growing dividend from this new higher base, which will continue to be determined after taking into account the Group's financial flexibility and our assessment of opportunities to generate attractive returns by investing in specific areas of the business. The Board believes that in the medium term a dividend cover of around two times is appropriate.

**Our financial objectives[1]**

In December 2010, we announced new objectives for the Group that reflect our determination to accelerate growth in Asia and our belief that we can continue to deliver both growth and cash sustainably to our shareholders.

Our core objectives are:

(i) In Asia, to double the 2009 value of IFRS life and asset management pre-tax operating profit in 2013 (2009: £465 million) and to double the 2009 value of new business profits in 2013 (2009: £713 million).

(ii) For each business unit to remit net cash to the Group: Asia to deliver £300 million of net cash remittance to the Group in 2013 (2009: £40 million); Jackson to deliver £200 million of net cash remittance to the Group in 2013 (2009: £39 million); UK to deliver £350 million of net cash remittance to the Group in 2013 (2009: £284[2] million).

(iii) All business units in aggregate to deliver cumulative net cash remittances of at least £3.8 billion over the period 2010 to end-2013. These net remittances are to be underpinned by a targeted level of cumulative underlying free surplus generation of £6.5 billion over the same period.

These objectives are clear evidence of our determination to provide – through our strategy and disciplined execution – both growth and cash to our shareholders at a sustained pace.

[1] The following discussion and the discussion under 'Outlook' below, contain forward-looking statements that involve inherent risks and uncertainties. Prudential's actual future financial condition or performance or other indicated results may differ materially from those indicated in any such forward-looking statement due to a number of important factors (including those discussed under the heading 'Risk factors' in this announcement). See the discussion under the heading 'Forward-looking statements' at the front of this announcement. The objectives assume current exchange rates and a normalised economic environment consistent with the economic assumptions made by Prudential in calculating the EEV basis supplementary information for the half-year ended 30 June 2010. They have been prepared using current solvency rules and do not pre-judge the outcome of Solvency II, which remains uncertain.

[2] Representing the underlying remittances excluding the £150 million impact of pro-active financing techniques used to bring forward cash emergence of the in-force book during the financial crisis.

**Outlook**

By continuing to implement our strategy with discipline, allocating capital to the most attractive markets and products, and managing risk and capital prudently, but proactively, we have generated differentiated performance from our peers.

The outlook for economic growth in Asia, particularly in our preferred markets in South-East Asia, remains positive. The prospects for sustainably growing our leading platform in the region continue to be strong. Our confidence is reflected in the ambitious, yet achievable, objectives we have set for our business in Asia in December 2010.

Regarding Western economies, we continue to be more cautious about the outlook, with some clear differences between the US and Europe. The US economy is recovering, and the combination of the transition of 78 million ‘baby boomers’ into retirement, and our skill base and products, creates a unique and exciting opportunity for us. The economic outlook in Europe is more challenging. However, having focused our UK business, and relying largely on our existing seven million customers, we believe that we will continue to achieve our objectives in terms of margins and capital and cash generation.

Our disciplined process of capital allocation will, I believe, enable us to continue to deliver improved cash returns to shareholders. Our diversification, combined with our flexibility to choose where to allocate our capital, have proved to be significant sources of competitive advantage. We successfully navigated the extreme economic and market cycle of the past two years and are confident we will continue to outperform in the markets where we compete in the future.

I believe that the quality of our strategic options, our discipline in putting value ahead of volume and our focus on execution will continue to allow us to grow profitably and to generate significant returns for our shareholders.

# Financial highlights

***Life APE new business sales, profits and investment in new business***

| | 2010 | | | 2009 | | | Change | | |
|---|---|---|---|---|---|---|---|---|---|
| | Sales £m | NBP [(a)] £m | Free surplus invested in new business £m | Sales £m | NBP [(a)] £m | Free surplus invested in new business £m | Sales change % | NBP change % | Free surplus invest-ment change % |
| Asia [(b)] | **1,501** | **902** | **278** | 1,209 | 725 | 231 | 24 | 24 | 20 |
| US | **1,164** | **761** | **300** | 912 | 664 | 326 | 28 | 15 | (8) |
| UK | **820** | **365** | **65** | 723 | 230 | 103 | 13 | 59 | (37) |
| Total Group | **3,485** | **2,028** | **643** | 2,844 | 1,619 | 660 | 23 | 25 | (3) |

(a) New Business Profit (NBP)
(b) Asia amounts exclude Japan, which ceased writing new business in 2010.

***New business profit (NBP) margin, IRRs and payback periods***

| | 2010 | | | 2009 | | |
|---|---|---|---|---|---|---|
| | NBP margin % | IRR[(c)] % | Payback period (years) | NBP margin % | IRR[(c)] % | Payback period (years) |
| Asia [(b)] | **60** | **>20** | **3** | 60 | >20 | 3 |
| US | **65** | **>20** | **1** | 73 | >20 | 2 |
| UK | **45** | **>20** | **4** | 32 | >15 | 5 |
| Total Group | **58** | **>20** | **2** | 57 | >20 | 3 |

(b) Asia amounts exclude Japan, which ceased writing new business in 2010.
(c) IRR = Internal Rate of Return

***Shareholder-backed policyholder liabilities and net liability flows***

| | 2010 | | 2009 | | Change | |
|---|---|---|---|---|---|---|
| | Shareholder-backed | | Shareholder-backed | | Shareholder-backed | |
| | Policyholder liabilities £m | Net liability flows [(d)] £m | Policyholder liabilities £m | Net liability flows [(d)] £m | Policyholder liabilities % | Net liability flows % |
| Asia | **17,716** | **1,298** | 13,050 | 2,055 | 36 | (37) |
| US | **60,523** | **7,368** | 48,311 | 5,189 | 25 | 42 |
| UK | **43,944** | **1,029** | 38,700 | (73) | 14 | 1,510 |
| Total Group | **122,183** | **9,695** | 100,061 | 7,171 | 22 | 35 |

(d) Defined as movements in shareholder-backed policyholder liabilities arising from premiums, surrenders, maturities and deaths.

***Asset management net inflows and profitability***

| | Net in-flows | | | IFRS operating profit | | | External funds under management | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2010 £m | 2009 £m | Change % | 2010 £m | 2009 £m | Change % | 2010 £m | 2009 £m | Change % |
| M&G | **9,105** | 13,478 | (32) | **284** | 238 | 19 | **89,326** | 70,306 | 27 |
| Total asset management | **8,890** | 15,417 | (42) | **378** | 297 | 27 | **111,374** | 89,780 | 24 |

*Operating profit based on longer-term investment returns - IFRS*

| | **2010** | | **2009** | | **Change** | |
|---|---|---|---|---|---|---|
| | **Long-term £m** | **Total £m** | **Long-term £m** | **Total £m** | **Long-term %** | **Total %** |
| Asia | **536** | **608** | 416 | 471 | 29 | 29 |
| US [(e)] | **833** | **855** | 618 | 622 | 35 | 37 |
| UK | **673** | **1,003** | 606 | 895 | 11 | 12 |
| Other income and expenditure [(f)] | **(4)** | **(525)** | (6) | (424) | 33 | (24) |
| Total Group | **2,038** | **1,941** | 1,634 | 1,564 | 25 | 24 |

(e) The Company has amended the presentation of IFRS operating profit for its US insurance operations to remove the net equity hedge accounting effect (incorporating related amortisation of deferred acquisition costs) and include it in short-term fluctuations. 2009 amounts have been amended accordingly.
(f) Including Solvency II implementation, restructuring, Asia development and Asia Regional Head Office costs.

*Operating profit based on longer-term investment returns - EEV*

| | **2010** | | **2009** | | **Change** | |
|---|---|---|---|---|---|---|
| | **Long-term £m** | **Total £m** | **Long-term £m** | **Total £m** | **Long-term %** | **Total %** |
| Asia | **1,450** | **1,522** | 1,105 | 1,160 | 31 | 31 |
| US | **1,458** | **1,480** | 1,233 | 1,237 | 18 | 20 |
| UK | **936** | **1,266** | 870 | 1,159 | 8 | 9 |
| Other income and expenditure [(g)] | **(4)** | **(572)** | (6) | (466) | 33 | (23) |
| Total Group | **3,840** | **3,696** | 3,202 | 3,090 | 20 | 20 |

(g) Including Solvency II implementation, restructuring, Asia development and Asia Regional Head Office costs.

*Basic earnings per share - based on operating profit after tax and non-controlling interests* [(h)]

| | **2010** | **2009** | **Change %** |
|---|---|---|---|
| IFRS | **62.0p** | 47.5p | 31 |
| EEV | **106.9p** | 88.8p | 20 |

(h) 2010 excludes an exceptional tax credit of £158 million which primarily relates to the impact of a settlement agreed with the UK tax authorities.

*Balance sheet, cash and capital*

| | **2010** | **2009** | **Change %** |
|---|---|---|---|
| Dividend per share relating to the reporting year | **23.85p** | 19.85p | 20 |
| Underlying free surplus generated [(i)] | **£1,714m** | £1,414m | 21 |
| IGD Capital before final dividend [(j)] | **£4.3bn** | £3.4bn | 26 |

(i) Underlying free surplus comprises underlying free surplus generated from in-force business less investment in new business.
(j) Estimated for 2010.

*Group shareholders' funds (including goodwill attributable to shareholders)*

| | **2010 £** | **2009 £** | **Change %** |
|---|---|---|---|
| IFRS | **8.0bn** | 6.3bn | 28 |
| EEV | **18.2bn** | 15.3bn | 19 |

| | **2010 %** | **2009 %** |
|---|---|---|
| Return on IFRS shareholder's funds [(k)] | **25** | 23 |
| Return on embedded value [(l)] | **18** | 15 |

(k) IFRS operating profit after tax and non-controlling interests (but excluding in 2010 exceptional tax credit of £158 million) as percentage of opening IFRS shareholders' funds.
(l) EEV operating profit after tax and non-controlling interests (but excluding in 2010 exceptional tax credit of £158 million) as percentage of opening EEV shareholders' funds.

| | **2010** | **2009** | **Change %** |
|---|---|---|---|
| EEV shareholders' funds per share (including goodwill attributable to shareholders) | **715p** | 603p | 19 |
| EEV shareholders' funds per share (excluding goodwill attributable to shareholders) | **658p** | 551p | 19 |

**CFO REVIEW**

**Introduction**

2010 was a good year for Prudential as we delivered strong performance in our key growth metrics. EEV new business profit ('new business profit') was up 25 per cent to £2,028 million (2009: £1,619 million) and IFRS operating profit based on longer-term investment returns ('IFRS operating profit') increased 24 per cent to £1,941 million (2009: £1,564 million). On our capital metric of net underlying free surplus generation we improved 21 per cent to £1,714 million (2009: £1,414 million). Prudential's ability to deliver on all of these metrics is testament to the quality of our businesses and marks us out among our peers. Our ongoing focus on driving value over volume coupled with our advantaged product and geographic business footprint and the financial discipline that is ingrained within all of our businesses has resulted in the Group delivering excellent performance in the year and gives us confidence as we look into 2011 and beyond.

**Growth**

In life insurance, APE sales[1] in 2010 were up 23 per cent to £3,485 million (2009: £2,844 million) and new business profit has increased by 25 per cent to £2,028 million (2009: £1,619 million) as our new business margins[1] increased to 58 per cent (2009: 57 per cent).

Asia produced APE sales[1] of £1,501 million (2009: £1,209 million) and new business profit[1] of £902 million (2009: £725 million) in 2010, both figures up 24 per cent on the prior year. AER sales performance across Asia was strong, particularly in Indonesia (up 49 per cent), Malaysia (up 40 per cent), Hong Kong (up 19 per cent) and Singapore (up 37 per cent) where we have a powerful market presence. Our agency and bancassurance channels both continue to flourish, each growing at a rate in excess of 25 per cent, and our health and protection rider strategy remains highly successful, with health and protection products representing 27 per cent of new business premiums in 2010.

Jackson delivered APE sales of £1,164 million (2009: £912 million) and £761 million of new business profit (2009: £664 million), up 28 per cent and 15 per cent respectively on the prior year. The decline in our new business margin in the US from 73 per cent in 2009 to 65 per cent in 2010 was expected. Nevertheless, Jackson successfully defended most of the exceptional margin gains achieved in 2009 in taking advantage of the extreme dislocation prevalent in the corporate bond market. Jackson has capitalised on the weakened competitive environment in the US life insurance market and has emerged as one of the top three players in the variable annuity market in terms of sales and number two in terms of net flows. However, our expansion in variable annuities has been opportunistic and this market share may not be sustained as competition re-emerges over the medium term.

In the UK, we delivered total retail and bulk annuity APE sales of £820 million (2009: £723 million) and new business profit of £365 million (2009: £230 million), up 13 per cent and 59 per cent respectively. At a retail level, new business profit of £257 million was up 15 per cent from £223 million in 2009 at an expanded margin of 35 per cent versus 31 per cent in the prior year. This reflects improved margins on with-profits bond sales where we have seen volumes 11 per cent higher on improved demand and the strong annuity margins experienced in 2009 continuing into 2010.

In asset management, we have delivered £8.9 billion of net inflows over 2010 compared with £15.4 billion in 2009, a year which benefited from exceptionally high flows into M&G's fixed income funds due to the credit spread environment at the time. M&G is the driver of our inflows in asset management, producing £9.1 billion (2009: £13.5 billion) of net inflows in the period (£7.4 billion retail, £1.7 billion institutional). M&G's track record in attracting positive net inflows is highly impressive, ranking number 1 in the UK retail market for the last nine consecutive quarters, making it one of the leading asset managers in Europe. At the end of 2010 it had external funds under management of £89.3 billion, an increase of £19.0 billion from the position at the beginning of the year; adding these funds to internal amounts, M&G's total funds under management were £198.3 billion. Asia asset management continues to make great strides forward attracting £1.8 billion of retail and institutional inflows in 2010 (2009: £556 million). These were offset by £2.1 billion of outflows (2009: £1.4 billion inflows) in low margin money market funds where sales and redemptions tend to be highly volatile.

[1] Excluding Japan which ceased writing new business in 2010.

It is encouraging to note that we continue to grow our balance sheet with shareholder-backed policyholder liabilities up by 22 per cent to £122 billion, benefiting from both net inflows and investment market movements. We continue to see positive net inflows into our life businesses, with a net £9.7 billion being received in 2010, an increase from the net £7.2 billion received in 2009. In asset management our Group net inflows as a percentage of opening external funds under management stands at 9.9 per cent for 2010. Both measures emphasise the significant organic growth we are delivering across the Group. In addition, the returns we expect to generate on the capital we invest in writing life new business have also reached a new high. For every £1 we invested in new business strain in 2010 we expect to generate £2.2 of post-tax new business profit and our initial capital investment is expected to be paid back within two years.

**Profitability**

In terms of profitability, we have successfully built on the momentum seen last year and delivered another strong performance thanks to a continued focus on our core disciplines of value creation and capital conservation. We have delivered record profitability in 2010 with Group IFRS operating profit up 24 per cent to £1,941 million (2009: £1,564 million) and Group EEV operating profit based on longer-term investment returns ('EEV operating profit') up 20 per cent to £3,696 million (2009: £3,090 million) equivalent to an annual return on embedded value of 18 per cent (2009: 15 per cent).

Central to this achievement is the active management of our portfolio of products and businesses, which in 2010 saw us cease writing new business in our Japanese life operations, exit from the equity release market in the UK, reduce our appetite for sales of fixed annuities in the US and target, instead, the highly profitable markets in South-East Asia (including Hong Kong) and variable annuities in the US. We have also remained opportunistic in the UK bulk annuity market and entered into one large transaction which comfortably exceeded our high return and short payback requirements.

In Asia, long-term business IFRS operating profit was up 29 per cent to £536 million in 2010 (2009: £416 million), a strong performance in and of itself, even before factoring in the £63 million one-off credit to the 2009 result from a change in reserving basis in Malaysia. The result benefited notably from strong performance in Indonesia, Malaysia, Singapore and Vietnam. In addition, management actions to close Japan to new business and refocus our operations in Korea and Taiwan have also helped to eliminate some of the negatives that were holding back our profitability. The ongoing build-out of distribution across South-East Asia, the success of our health and protection rider strategy, and the underlying strength of the economies in which we operate should drive continuing strong growth in Asia IFRS operating profit going forward. Asia's long-term EEV operating profit, a measure of the economic value creation in the year, grew by 31 per cent in 2010 to £1,450 million (2009: £1,105 million) further underlining the creation of sustainable value by these operations.

In the US, long-term business IFRS operating profit was up 35 per cent from £618 million in 2009 to £833 million in 2010. Jackson's impressive growth in the variable annuity market is a key driver behind its improved profitability. The 'fees on assets' that Jackson earns on separate account assets are the highest across the Group's unit-linked businesses, and these revenues have increased significantly as these assets have grown by over 51 per cent during 2010 to £31 billion at the end of the year. The majority of this asset growth has come from £5.8 billion of net inflows in the period (2009: £3.6 billion). Jackson's general account has also contributed to the growth in IFRS profits during the period. The size of the general account was up slightly during 2010, and closed the year with policyholder liabilities of £29 billion but the average spread margin that we earn on these liabilities increased from 179 bps in 2009 to 243 bps in 2010. This included a £108 million benefit from various transactions undertaken during 2010 to more closely match the overall asset and liability duration, as well as management actions to lower crediting rates on fixed annuities. These actions also had the effect of improving the 2010 EEV operating profits by 18 per cent to £1,458 million (2009: £1,233 million).

In the UK long-term business IFRS operating profit was up by 11 per cent from £606 million in 2009 to £673 million in 2010. Our UK business continues to optimise the balance between growth and cash generation. The improvement in IFRS operating profit reflects the benefit of cost saving initiatives, higher with-profits income and increased annuity profits arising principally from a bulk annuity contract which contributed £63 million to the total. At eight per cent, growth in EEV operating earnings to £936 million (2009: £870 million) was in line with our strategy.

In asset management IFRS operating profit was up 27 per cent to £378 million compared to £297 million in 2009. M&G had a strong year benefiting from rising markets and the strong inflows described above, resulting in IFRS operating profit up 19 per cent to £284 million in 2010 (2009: £238 million). Asia asset management produced IFRS operating profit of £72 million up 31 per cent on the prior year (2009: £55 million), also benefiting from rising markets and an element of improving mix as £1.8 billion of high margin retail and institutional net inflows offset £2.1 billion of low margin money market net outflows.

**Capital generation**

Our strategy of efficiently deploying our capital to those products and geographies with the most attractive profitability characteristics has, over the past three years, transformed the capital position of our business. Across the Group, we are now producing very significant amounts of free capital, which we measure as free surplus generated. Our first priority for the use of this capital is reinvestment in new business as we can achieve attractive internal rates of return (IRRs) and rapid paybacks on this investment. However, such is the scale and efficiency of our businesses, we are now producing significant amounts of free surplus over and above that which we can reinvest in new business. This excess free surplus generation is being used to continue to strengthen our balance sheet and to increase cash returns to our shareholders.

In 2010, we generated £2,359 million of underlying free surplus from our in-force business, up 13 per cent from £2,089 million in 2009, and we reinvested £645 million of this into writing new business. Asia is the priority destination when it comes to reinvesting our capital and Prudential Corporation Asia (PCA)'s growth is not constrained by the supply of capital from the Group. In the US, we invest in an opportunistic manner reflecting the market and competitive environment at the time. In the UK, we take a selective approach and focus only on lines of business where we believe we have both the scale and expertise to compete successfully. In asset management, our businesses require minimal capital to fund growth. Thus, the split of the investment in new business in 2010 was £280 million into Asia, £300 million into the US and £65 million into the UK. The IRRs on this invested capital were more than 20 per cent in Asia, the US and the UK; with payback periods of three years, one year and four years respectively.

Of the remaining free surplus generated after reinvestment in new business, £935 million was remitted from the business units to Group. This cash was used to meet central costs (including those associated with Solvency II implementation) of £180 million, service net interest payments of £231 million and meet dividend payments (net of scrip) of £449 million. In 2010, we also incurred significant exceptional cash outflows relating to the AIA transaction costs of £377 million (pre-tax) and we utilised our central resources to fund the acquisition of UOB Life of £276 million. Our central cash resources amounted to £1,232 million at the end of the year, comfortably above the £1 billion holding company cash buffer we seek to retain.

The remaining free surplus generated in the period was retained within our businesses and this will bolster local capital ratios. The total free surplus balance deployed across our life and asset management operations increased from £2,531 million at the beginning of the period to £3,338 million at the end of the period.

## New financial objectives – ‘Growth and Cash’

*The following discussion contains forward-looking statements that involve inherent risks and uncertainties. Prudential’s actual future financial condition or performance or other indicated results may differ materially from those indicated in any such forward-looking statement due to a number of important factors (including those discussed under the heading ‘Risk factors’ in this announcement). See the discussion under the heading ‘Forward-looking statement’ at the front of this announcement.*

At our 2010 investor conference entitled ‘Growth and Cash’ we announced new financial objectives demonstrating our confidence in continued rapid growth in Asia, and increasing levels of cash remittances from all of our businesses. These objectives were defined as follows:

(i) Asia growth and profitability objectives[1]:

- To double the 2009 value of IFRS life and asset management pre-tax operating profit in 2013 (2009: £465 million); and
- To double the 2009 value of new business profits in 2013 (2009: £713 million).

(ii) Business unit cash remittance objectives[1]:

- Asia to deliver £300 million of net cash remittance to the Group in 2013 (2009: £40 million);
- Jackson to deliver £200 million of net cash remittance to the Group in 2013 (2009: £39 million);and
- UK to deliver £350 million of net cash remittance to the Group in 2013 (2009: £284 million[2]);

(iii) Cumulative net cash remittances[1]:

- All business units in aggregate to deliver cumulative net cash remittances of at least £3.8 billion over the period 2010 to end-2013. These net remittances are to be underpinned by a targeted level of cumulative underlying free surplus generation of £6.5 billion over the same period.

The table below shows our progress towards these objectives from our results in 2010. We believe we have made a strong start towards achieving these objectives.

| | Actual | | Objective |
|---|---|---|---|
| | **2009** | **2010** | **2013** |
| | **£m** | **£m** | **£m** |
| **Asia Growth Objectives** | | | |
| Value of new business (including Japan) | 713 | 901 | **1,426** |
| IFRS operating profit* | 465 | 604 | **930** |
| **Business Unit Net Remittance Objectives** | | | |
| Asia | 40 | 233 | **300** |
| Jackson | 39 | 80 | **200** |
| UK** | 434 | 420 | **350** |
| M&G*** | 175 | 202 | |
| Total | 688 | 935 | |
| **Cumulative net cash remittances from 2010 onwards** | | | **3,800** |
| **Cumulative underlying group free surplus generation net of investment in new business** | | | **6,500** |

* Total Asia operating profit from long-term business and asset management after development costs.
** In 2009, the net remittances from the UK include the £150 million in 2009 arising from the pro-active financing techniques used to bring forward cash emergence of the in-force book during the financial crisis. The 2010 net remittances include an amount of £120 million representing the releases of surplus and net financing payments.
*** Including PruCap.

In 2010 net remittances from business operations increased to £935 million, equivalent to 55 per cent of underlying free surplus generated (after investment in new business) of £1,714 million. The increased level of net remittances further illustrates both the strong and improving capital generative nature of our business, with a greater proportion of this capital being returned to the corporate centre in the form of dividends. The delivery of the 2010 – 2013 financial objectives will see this trend continue.

[1] The objectives assume current exchange rates and a normalised economic environment consistent with the economic assumptions made by Prudential in calculating the EEV basis supplementary information for the half-year ended 30 June 2010. They have been prepared using current solvency rules and do not pre-judge the outcome of Solvency II, which remains uncertain.

[2] Representing the underlying remittances excluding the £150 million impact of pro-active financing techniques used to bring forward cash emergence of the in-force book during the financial crisis.

## Capital position, financing and liquidity

The Group has continued to maintain a strong capital position. At the end of 2010 our IGD surplus stood at £4.3 billion (2009: £3.4 billion), with coverage a very strong 3.0 times the requirement. All of our subsidiaries maintain strong capital positions at the local regulatory level. In particular, Jackson's RBC ratio has continued to strengthen throughout the period under review and at the end of 2010 this ratio stood at 483 per cent.

In the UK we continue to hold a £1.8 billion credit reserve on a Pillar 1 basis as protection against future credit losses. In 2010 we suffered no defaults.

Solvency II, which is expected to be implemented from 1 January 2013, represents a complete overhaul of the capital adequacy regime for European insurers. We welcome the risk-based focus of the Solvency II regime but, along with our European peers, we do have concerns about the degree of prudence built in within the proposed calibrations for the standard formula. We are engaging directly with our peers, politicians and regulators to ensure a fair and reasonable outcome before the regime becomes law.

Our financing and liquidity position has remained strong throughout the period. The next call on external financing is in December 2011 on the €500 million Tier 2 subordinated notes. In early 2011 we successfully issued US$550 million Tier 1 subordinated debt in anticipation of calling the €500 million Tier 2 notes.

We continue to engage with rating agencies in order to provide insurance financial strength ratings for the Group. Prudential is currently rated A+ by S&P, A2 (negative outlook) by Moody's and A by Fitch.

## Embedded value

EEV shareholders' funds increased by 19 per cent during 2010 to £18.2 billion (2009: £15.3 billion). On a per share basis EEV at the end of 2010 stood at 715 pence, up 19 per cent from the end of 2009 (2009: 603 pence).

## 2010 dividend

In view of the progress that the Group has made in recent years to improve IFRS operating profitability and free surplus generation, the Board has decided to rebase the full year dividend upwards by 4 pence per share, equivalent to an increase of 20 per cent. In line with this, the directors recommend a final dividend of 17.24 pence per share, which brings the total dividend for the year to 23.85 pence per share (2009: 19.85 pence per share). The scrip dividend scheme is not being offered in respect of this dividend. In its place shareholders will be offered a Dividend Reinvestment Plan ('DRIP').

The Board will maintain its focus on delivering a growing dividend from this new higher base, which will continue to be determined after taking into account the Group's financial flexibility and our assessment of opportunities to generate attractive returns by investing in specific areas of the business. The Board believes that in the medium term a dividend cover of around two times is appropriate.

## Summary

2010 was a good year for the Group in uncertain conditions as global economies emerged from the financial crisis. These results demonstrate that we are maximising the growth opportunities of our high quality franchises in Asia, the US, and the UK. We remain disciplined in our approach of optimising value and are very focused on improving the quality of our earnings. We have accelerated the generation of free surplus and we are signalling our confidence in the future potential of our business by proposing an increase in the payout to shareholders.

## BUSINESS UNIT REVIEW

### Insurance operations

### Asia operations

| | | AER | | CER | |
|---|---|---|---|---|---|
| | **2010 £m** | **2009 £m** | **Change %** | **2009 £m** | **Change %** |
| APE sales (excluding Japan) | **1,501** | 1,209 | 24 | 1,300 | 15 |
| NBP (excluding Japan) | **902** | 725 | 24 | 783 | 15 |
| NBP margin (excluding Japan) (% APE) | **60%** | 60% | | 60% | |
| Total IFRS operating profit* | **536** | 416 | 29 | 451 | 19 |
| Total EEV operating profit* | **1,450** | 1,105 | 31 | 1,190 | 22 |

*Operating profit from long-term operations including Japan but excluding asset management operations, development costs and Asia regional head office expenses.

### Introduction

The Asian economies continue to lead the world in terms of current and prospective growth and it is clear that Asia's historic reliance on exports is increasingly balanced with rapidly growing domestic consumption. Across the region, we are seeing major demographic and socioeconomic changes – with the emergence of a sizeable and growing middle class. The Asian Development Bank estimates that there are now over 1.9 billion middle class Asians, a threefold increase since 1990 and this means that, within a generation, hundreds of millions of households in the region have ascended from poverty to living standards and lifestyle aspirations that are consistent with those seen in Western Europe and the US. These are urbanised households that are smaller, that are better educated, that want good quality housing, consumer goods, access to good medical services, transport, holidays, entertainment, education, to provide a quality of life for their children that is better than the one they had and not least to have a long life with a comfortable retirement.

Household savings rates in Asia have historically been multiples of those in the UK and US and in markets where little exists in the way of state backed social security benefits or welfare support, the need to save in case of an unplanned life changing event such as a medical incident involving hospitalisation is real and strong. As households have become wealthier the quantum of these emergency funds has increased materially, resulting in significant amounts of undeployed or under-deployed capital waiting to be brought into the formal economy as they migrate to insurance companies' and banks' balance sheets. Life insurance companies are ideally placed to provide some financial protection and security to household balance sheets.

Although there will inevitably be some short-term fluctuations in demand for life insurance and asset management products as other factors come into play, the fundamental social and political drivers for growth in these sectors will continue to support long-term growth.

## Business overview

*Market overview*

Overall, Asia's life insurance industry saw a sharp recovery in new business volumes during 2010 as markets moved beyond the 2008/2009 crisis.

The competitive landscape for the life sector varies by market but has largely remained consistent with that seen in prior years. Most markets feature a mix of local and multinational players whose definitions of business success may differ.

Competition is primarily around securing distribution. With insurance penetration rates being generally low, growth is less constrained by the size of the market than by companies' ability to further expand it by adding distribution and making their products available to parts of the population who have never used them. A large proportion of sales in markets with low penetration are to consumers who have never bought a policy before, thus expanding the market itself.

Tied agency continues to dominate although distribution through banks is becoming increasingly significant, with examples like HSBC Life and Bank of China Life in Hong Kong. Across the region there is little direct competition on products; there are no patents or copyrights in life insurance, or on product pricing, where regulators typically define the parameters for the industry.

The region's life insurance regulators tend to adopt a conservative stance and remain focused on driving development of the sector in a way that balances the need to ensure consumers have, first and foremost, access to appropriate products that are sold in a fair and transparent manner with the need to reward shareholders for taking on the risks of investing in the development of a relatively young and capital intensive industry. The industry also employs millions of people in the region, an important consideration when high unemployment rates can be a catalyst for political friction. India saw the most impactful regulatory change during 2010, which in summary, was designed to shift the emphasis of the industry away from products which are mostly investment orientated and encourage more traditional savings and protection.

A positive development in a number of markets has been the development of the financial press. Many leading publications carry regular sections on personal financial planning and there is healthy debate on the uses of particular types of product. Prudential is a champion of improving standards of financial literacy.

*Strategy overview*

The overarching objective for Prudential in Asia is to continue building scale profitably, leveraging our advantaged platform. The strategic priorities articulated in 2006 remain entirely relevant and continue to be driven in a highly focused and disciplined way. While market outperformance in terms of new business growth is an indicator of scale, we do not pursue volume for its own sake as we put profitability, returns on capital and capital efficiency ahead of topline growth.

One of the key components of our strategy is driving agency distribution scale and productivity. Our agency structures are differentiated by market depending upon their size and maturity with the management emphasis balanced between recruitment (newer markets like Indonesia and Vietnam) and productivity growth (more established markets like Hong Kong and Singapore). However this is a simplification as those two priorities are always present and not mutually exclusive; local management will always focus on both.

Prudential's agency management competencies drive effective selection discipline and training designed to 'fast start' new agents and improve the skills and productivity of the more experienced ones. Our combination of training programmes, comprehensive product suites, specialised support allowing agents to address the evolving needs of existing customers and technology solutions to facilitate the fact finding and proposal submission processes combine to add value to agents, shareholders and customers.

During 2010 total average agent numbers excluding India at 154,000 were up 7.5 per cent over 2009. In India, where significant regulatory changes were introduced during the year, agent numbers were down 27 per cent to 168,000 at the end of December 2010. This is in line with our strategy to rationalise expense levels and focus on productivity improvements, which puts us in a strong position to respond to the recent regulatory changes. Excluding India, our agency productivity in terms of average APE per agent increased by 10 per cent.

Prudential is a pioneer and regional leader in partnership distribution in Asia. Key success drivers are our expertise in developing, training and motivating in branch insurance specialists and our investment in enduring and mutually beneficial relationships with our partners, including Standard Chartered Bank across the region, E.Sun in Taiwan and most recently United Overseas Bank in Singapore, Thailand and Indonesia.

Prudential's product mix continues its emphasis on regular premium policies and protection riders. The high proportion of health and protection, standalone and riders, at 27 per cent of new business premiums in 2010, supports the new business profit margins and reflects the higher proportion of risk based products in our book than some competitors who focus on single premium investment orientated policies.

Prudential currently insures over 11 million life customers in Asia and has 15 million in force policies. Highlighting the value Prudential policies have for our customers, we paid out £2.6 billion in claims and maturities during 2010. This customer base is a tremendously valuable asset as over 40 per cent of new business APE came from existing customers in 2010 (excluding India). This reflects our enduring relationship with our customers and how our solutions are meeting their needs over time. The customer retention rate continues to improve and at 91 per cent it is one per cent up on 2009.

**Financial performance**

New business for the fourth quarter was a new record at £435 million, up eight per cent on the same period last year, which was already a record quarter and the full year 2010 was £1,501 million up 24 per cent on 2009 and an impressive 44 per cent ahead of 2007, the last full year to be unaffected by the 2008/2009 financial crisis. Agency remains the largest distribution channel accounting for 66 per cent of new business volumes and with the proportion from bancassurance increasing from 25 per cent to 26 per cent. The proportion of linked and protection business remained broadly in line with prior year at 41 per cent and 27 per cent respectively. With the economic recovery, the size of average cases, excluding India, increased nine per cent. Importantly, our continued emphasis on regular premium business is reflected in its 93 per cent contribution to total APE, which is also in line with prior year.

New business market share statistics for full year 2010 are not yet available but based on our estimates and market intelligence we expect to have retained or improved our market rankings in most markets across the region.

Consistent with our 'value over volume' priority we have maintained our product and pricing disciplines. New business profits of £902[1] million are up 24 per cent over 2009. Average new business profit margins have remained the same as prior year at 60 per cent, with the positive impacts of country mix changes having largely been offset by operating assumption changes.

[1] Excluding Japan which ceased writing new business in 2010.

In-force operating profits from long-term business of £549 million are up 40 per cent on prior year. This increase reflects the growing size of the in-force book and a significantly reduced level of net negative operating experience variance at £1 million compared to negative £85 million in 2009, which, in part, reflects lower adverse persistency variances of negative £48 million compared with the 2009 level of negative £76 million. The net negative variance level of £1 million is small relative to the size of the EEV shareholders' funds (before goodwill) of £7.4 billion.

Full year 2010 operating profits from long-term business reported under the IFRS basis were £536 million, up 29 per cent over 2009 reflecting increased crystallisation of profits from the in-force book and lower new business strain of four per cent of APE compared to six per cent last year[1]. All operations aside from Japan, China and Taiwan made an IFRS profit in 2010.

Underlying free surplus net of investment in new business has improved to £326 million in 2010 compared to £119 million in 2009 driven principally by growth in in-force profits reflecting the increasing size and inherent profitability of the in-force book.

The life business significantly increased remittance of cash to the Group in 2010, at £267 million up from £80 million in 2009. This includes an exceptional £130 million from Malaysia representing the remittance of distributable earnings accumulated over recent years. Whilst this one-off type of remittance will not be repeated, it further demonstrates our ability to upstream cash from the region.

Looking at individual countries:

*China*

| | AER | | | CER | |
|---|---|---|---|---|---|
| | **2010 £m** | **2009 £m** | **Change %** | **2009 £m** | **Change %** |
| APE sales | 58 | 45 | 29 | 46 | 26 |

In **China**, Prudential's 50 per cent share of new business volumes for 2010 was £58 million up 29 per cent on prior year. Agency remains the largest distribution channel although bank distribution grew at a slightly faster pace, up 35 per cent. Leading bank partners are SCB, CITIC and ICBC. In a market where bank sales are overwhelmingly dominated by single premium investment products it is important to note that 25 per cent of our bank channel APE is now regular premium unit-linked business.

CITIC-Prudential remains one of the leading foreign joint ventures and we continue to pursue our strategy of quality sales and sustainable value creation rather than trying to achieve short-term sales volume growth.

*Hong Kong*

| | AER | | | CER | |
|---|---|---|---|---|---|
| | **2010 £m** | **2009 £m** | **Change %** | **2009 £m** | **Change %** |
| APE sales | 287 | 241 | 19 | 244 | 18 |

**Hong Kong** delivered an excellent result in 2010 with new business APE of £287 million up 19 per cent on prior year. Our continuing success in this market is underpinned by the quality of both our distribution and product development. In 2010 some 42 per cent of our new business sales were from new products launched in the year.

Our average agency headcount increased by 15 per cent, principally through organic recruitment initiatives, closing the year with an agency count in excess of 5,000. Our long-term bancassurance relationship with Standard Chartered Bank saw a strong rebound following the 2008/2009 Crisis. In-branch insurance specialists continue to focus on recurring premium savings and protection products and the profitability of the product mix continues to improve. Bancassurance now accounts for 37 per cent of our total sales, growing by 24 per cent in 2010.

[1] Excluding Japan which ceased writing new business in 2010.

*India*

| | AER | | | CER | |
|---|---|---|---|---|---|
| | **2010 £m** | **2009 £m** | **Change %** | **2009 £m** | **Change %** |
| APE sales | 188 | 168 | 12 | 179 | 5 |

The **India** market has been through a significant period of change during 2010, particularly with the regulatory driven refocus on savings and protection products, which came into effect on the 1st September. Sales have fallen by 56 per cent in the last quarter of the year and we expect that the unit-linked market will remain disrupted in the short-term. Nevertheless during 2010 ICICI-Prudential grew new business APE by 12 per cent to £723 million (Prudential's 26 per cent share is £188 million). Agency remains the largest distribution channel and following reductions in the size of the agency force, initiatives to improve agency productivity are delivering good results.

*Indonesia*

| | AER | | | CER | |
|---|---|---|---|---|---|
| | **2010 £m** | **2009 £m** | **Change %** | **2009 £m** | **Change %** |
| APE sales | 283 | 190 | 49 | 219 | 29 |

Prudential's business in **Indonesia** where we sell both conventional and takaful products, continues to be a clear market leader. New business volumes for 2010 of £283 million were driven by a very effective agency management approach that prioritises not only disciplined recruitment but also professional training and activation programmes. Average agency numbers have increased by 5 per cent during 2010 (to 81,000) and APE per active agent is higher by 21 per cent. Our agency generates over 90 per cent of total new business and this is predominantly regular premium unit-linked with protection riders.

During 2010 we have added new bancassurance agreements with UOB, SCB and Permata.

*Korea*

| | AER | | | CER | |
|---|---|---|---|---|---|
| | **2010 £m** | **2009 £m** | **Change %** | **2009 £m** | **Change %** |
| APE sales | 96 | 122 | (21) | 135 | (29) |

In **Korea** we remain focused on writing profitable business and remain resolute in our unwillingness to compete in the low margin, capital-intensive guaranteed products sector. New business volumes of £96 million for 2010 are 21 per cent lower than last year. We remain confident in our approach and the value this is generating for shareholders. The fourth quarter 2010 APE sales at £27 million were four per cent higher than the fourth quarter 2009. Persistency in Korea continues to improve.

*Malaysia*

| | AER | | | CER | |
|---|---|---|---|---|---|
| | **2010** | **2009** | **Change** | **2009** | **Change** |
| | **£m** | **£m** | **%** | **£m** | **%** |
| APE sales | 204 | 146 | 40 | 163 | 25 |

Our traditional and takaful businesses in **Malaysia** had a record 2010 with new business APE of £204 million. In local currency terms we are the first insurer in the history of the industry to pass RM1 billion in new business APE in a year. This growth has been driven primarily by the agency channel where the strategy to expand into the Bumi and takaful sectors has proven to be successful with our average agent numbers increasing by nine per cent (to 13,000 of which 46 per cent are Bumi). Productivity initiatives targeting the enhancement of existing policies have also been very effective, for example a recent offer to upgrade a health plan resulted in a 30 per cent take up rate. Average APE per agent is 16 per cent higher reflecting both renewed confidence in the market and the impact of these cross selling initiatives.

*Singapore*

| | AER | | | CER | |
|---|---|---|---|---|---|
| | **2010** | **2009** | **Change** | **2009** | **Change** |
| | **£m** | **£m** | **%** | **£m** | **%** |
| APE sales | 175 | 128 | 37 | 138 | 27 |

**Singapore** also had a very strong 2010 with new business of £175 million up 37 per cent on prior year with improvements in agency productivity (APE per agent up 15 per cent) and the very successful launch of bancassurance with UOB that generated 11 per cent of new business.

*Taiwan*

| | AER | | | CER | |
|---|---|---|---|---|---|
| | **2010** | **2009** | **Change** | **2009** | **Change** |
| | **£m** | **£m** | **%** | **£m** | **%** |
| APE sales | 120 | 107 | 12 | 114 | 5 |

Following our exit of the agency channel in 2009, **Taiwan** is now successfully focused on bank distribution principally with partners E.Sun and SCB. New business volumes of £120 million for the year are up 12 per cent on prior year and Taiwan remains a material contributor to Asia's results.

*Others – Philippines, Thailand and Vietnam*

| | AER | | | CER | |
|---|---|---|---|---|---|
| | **2010** | **2009** | **Change** | **2009** | **Change** |
| | **£m** | **£m** | **%** | **£m** | **%** |
| APE sales | 90 | 62 | 45 | 62 | 45 |

**Vietnam** delivered a very strong result in 2010, up 17 per cent on the prior year, driven by improvements in agency manpower and productivity. Although still relatively small both **Philippines** and **Thailand** delivered excellent results with APE up 109 per cent and 63 per cent respectively. Our new distribution agreement with UOB in Thailand has made a strong start, contributing 41 per cent of total APE and helping to nearly double our market share.

*Japan*

As previously announced, PCA Life **Japan** ceased writing new business with effect from 15 February 2010. Sales for Japan in 2010 amounted to £7 million (2009: £52 million). In order to reflect the results of our ongoing Asian operations, APE sales and NBP metrics included in this announcement exclude the contribution from Japan.

## US operations

| | AER | | | CER | |
|---|---|---|---|---|---|
| | **2010** | **2009** | **Change** | **2009** | **Change** |
| | **£m** | **£m** | **%** | **£m** | **%** |
| APE sales | **1,164** | 912 | 28 | 924 | 26 |
| NBP | **761** | 664 | 15 | 673 | 13 |
| NBP margin (% APE) | **65%** | 73% | | 73% | |
| Total IFRS operating profit*† | **833** | 618 | 35 | 626 | 33 |
| Total EEV operating profit* | **1,458** | 1,233 | 18 | 1,249 | 17 |

*Based on longer-term investment returns and excluding broker-dealer, fund management and Curian.
† The Company has amended the presentation of IFRS operating profit for its US operations to remove the net equity hedge accounting effect (incorporating related amortisation of deferred acquisition costs) and include it in short-term fluctuations. 2009 amounts have been amended accordingly.

### Introduction

The United States is the world's largest retirement savings market. Each year, more of the 78 million baby boomers[1] reach retirement age, triggering a shift from savings accumulation to retirement income generation for more than $10 trillion of accumulated wealth over the next decade[2].

During 2010, the US financial services industry continued to face many challenges. The recovery witnessed in the first quarter reversed in the second quarter but was more visible again in the third and fourth quarters. At half year, the S&P 500 index was down 7.6 per cent, 10-year Treasury rates had dropped below three per cent, swap rates had declined to near historic lows, AA corporate spreads had increased slightly and volatility had risen to levels more consistent with the first half of 2009. By year-end, the S&P 500 index was up 12.8 per cent for the year. Rates on 10-year Treasuries, which continued to decline through the third quarter before increasing in the fourth quarter, finished the year at 3.3 per cent, down from 3.9 per cent at the end of 2009. Swap rates also declined through the third quarter before rebounding slightly in the fourth quarter, although they still were near historic lows at year-end. Corporate AA spreads and volatility both declined through the second half of the year to fall below year-end 2009 levels.

We believe these unstable market conditions continue to provide a competitive advantage to companies with strong financial strength ratings and a relatively consistent product set. Companies that were hardest hit by the market disruption over the last few years are in general still struggling to regain market share as customers and distributors continue to seek product providers that offer consistency, stability and financial strength. Jackson continues to benefit significantly from this flight to quality as its financial strength ratings from the four primary rating agencies have remained unchanged for more than eight years. Through its financial stability and innovative products that provide clear value to the consumer, Jackson has enhanced its reputation as a high-quality and reliable business partner, with sales increasing as more advisers have recognised the benefits of working with Jackson.

Jackson's strategy continues to focus on balancing volume and capital consumption for both variable and fixed annuities. Jackson continued to sell no institutional products during 2010, as available capital was directed to support higher-margin variable annuity sales.

### Business overview

Initiatives in 2010

*Continue to innovate around our key variable annuity product*

Jackson continues to be innovative in its product offerings, implementing various changes in 2010 to increase sales, to comply with revised regulations or to enhance risk management flexibility and/or increase profitability.

[1] Source: US Census Bureau
[2] Source: McKinsey

In 2010, Jackson added two new optional lifetime guaranteed minimum withdrawal benefits (GMWBs) to its variable annuity products. LifeGuard Freedom 6 Net GMWB, introduced in May, gives investors the opportunity to help offset their tax liability by increasing their available withdrawal amounts to generate more income. LifeGuard Freedom Flex, introduced in October, is the industry's first customisable guaranteed minimum withdrawal benefit. Freedom Flex extends the menu-driven construction that Jackson offers in its variable annuity products, which gives investors the ability to build a personalised benefit based on their individual retirement planning objectives, while paying only for those options elected. Additionally, Jackson added six portfolios from American Funds and added BlackRock, managing two portfolios, to its variable annuity fund line-up during the year.

*Continue to focus on improving efficiency of operations*

Jackson continues to invest in its back office staffing and systems to provide world class customer service in an efficient and cost effective manner. In 2010, for the fifth consecutive year, Jackson was rated as a 'World Class' service provider by Service Quality Measurement Group[1]. Jackson was able to provide this level of service in 2010 while processing record retail sales and maintaining its ratio of statutory general expenses to average assets (one measure of efficiency) at the 2009 level of 44 basis points.

*Expand retail operation*

With consistent, high-quality wholesaling support and customer service, combined with stability in product offering, pricing and financial strength ratings and the ability to bring new products to market swiftly, Jackson continues to be an attractive business partner for its long-term distributors, as well as attract new distributors. During 2010, Jackson increased the number of licensed agents and registered representatives by 34 per cent to more than 130,000.

**Financial performance**

IFRS pre-tax operating profit for the long-term business was £833 million in 2010, up 35 per cent over the £618 million in 2009. This increase was primarily due to higher separate account fee income due to substantial positive net flows and the improved equity markets and higher spread income.

At 31 December 2010, Jackson had £31 billion in separate account assets, more than doubling the balance in the last 18 months. Separate account assets in 2010 averaged £9 billion higher than during 2009, reflecting the impact of sales and the higher average market levels. This growth resulted in variable annuity separate account fee income of £506 million in 2010, up 56 per cent over the £324 million in 2009.

Total spread income, including the expected return on shareholders' assets, of £817 million increased 31 per cent over the £622 million in 2009, primarily due to decreased crediting rates on fixed annuities and higher income on the growing general account assets. Jackson undertook various interest rate swap transactions during 2010 to more closely match the overall asset and liability duration, benefiting spread income in 2010 by £108 million.

Acquisition costs have increased in absolute terms compared to 2009 due to the significant increase in sales. However, acquisition costs as a percentage of APE has fallen from 76 per cent in 2009 to 73 per cent in 2010 as more advisors are electing to take asset based commissions which are paid over the life of the policy based on fund value. This asset based commission is not a deferrable acquisition cost and is expensed in the current period as an administration expense.

DAC amortisation of £334 million in 2010 compared to £223 million in 2009. 2010 includes £11 million additional amortisation as equity market returns fell below assumed rates (2009: £39 million benefit from improved equity markets). Excluding this effect, the underlying amortisation increased £61 million due to higher gross profits.

Administration expenses totalling £344 million in 2010 compared to £259 million in 2009, with the increase due primarily to higher asset based commissions which are excluded from acquisition costs.

[1] Source: Service Quality Measurement Group

With the improvement in the bond markets in 2010, and active management of the investment portfolio to reduce certain investment risks, Jackson realised net gains of £11 million in 2010 compared to net realised losses of £506 million in 2009. Jackson incurred losses, net of recoveries and reversals, on credit related sales of bonds of £89 million (2009: less than £1 million). Write downs were £124 million (£630 million in 2009), including £71 million on RMBS and £39 million on ABS. More than offsetting these losses were interest related gains of £224 million (2009: £125 million), primarily due to sales of lower rated CMBS and corporate debt.

Gross unrealised losses improved from £966 million at 31 December 2009 to £370 million at 31 December 2010. The net unrealised gain position has also improved significantly, from £4 million at 31 December 2009 to £1,210 million at 31 December 2010 due primarily to a decline in the US Treasury rates.

Jackson delivered record retail APE sales of £1,164 million in 2010, representing a 28 per cent increase over 2009. With no institutional sales in 2010, total APE sales were also £1,164 million, the highest total in the company's history. This achievement further demonstrates the resilience of Jackson's business model, as well as stability of our high-quality product offerings, exceptional wholesaling support and consistency demonstrated throughout the economic downturn.

While the equity markets rebounded in 2010, reaching two-year highs in December, and in light of continued volatility in US equity markets and historically low interest rates, customers continue to seek to mitigate equity risk while receiving an acceptable return through the purchase of variable annuities with guaranteed living benefits. Jackson is a beneficiary of this trend while being well placed to benefit from the huge wave of baby boomers starting to retire, as they increasingly use variable annuities to structure their retirement income.

In 2010, record variable annuity APE sales of £948 million were up 48 per cent from 2009. Jackson ranked third in new variable annuity sales in the US in 2010 with a market share of 11 per cent, up from fourth and a market share of eight per cent in 2009[1]. With significant sales increases and continued low surrender rates, Jackson held steady with its ranking of second in variable annuity net flows in 2010[4].

Fixed annuity APE sales of £84 million were down 20 per cent from the prior year, as consumer demand for the products fell due to the continued low interest rate environment. Jackson's new business opportunities were balanced with the goals of capital and cash conservation. Jackson ranked eighth in sales of traditional deferred fixed annuities through the third quarter of 2010, with a market share of three per cent compared to 13th with a two per cent market share for the full year 2009[2].

Fixed index annuity (FIA) APE sales of £109 million in 2010 were down 24 per cent from 2009 as Jackson focused its marketing efforts on the higher margin variable annuity products. Jackson ranked sixth in sales of fixed index annuities through the first three quarters of 2010, with a market share of five per cent, down from fourth and a market share of eight per cent for the full year 2009[3].

Retail annuity net flows increased 38 per cent, benefiting from record sales and continued low levels of surrender activity.

Jackson achieved extraordinary EEV new business margins in 2009, partially as a result of our ability to take advantage of the extreme dislocation prevalent in the corporate bond market. While the recovery in the corporate bond market has led to somewhat lower EEV new business margins due to lower spreads in 2010, we continue to write new business at internal rates of return in excess of 20 per cent.

The exceptionally high EEV spread levels in 2009 included an allowance that crediting rates and spreads would normalise in the future.

[1] Source: Morningstar
[2] Source: LIMRA
[3] Source: AnnuitySpecs
[4] Source: SimFund

EEV basis new business profits of £761 million were up 15 per cent on 2009, reflecting a 28 per cent increase in APE sales offset somewhat by lower new business margins. Total new business margin was 65 per cent, compared to 73 per cent achieved in 2009.

The variable annuity new business margin of 72 per cent in 2010 decreased somewhat from 81 per cent in 2009, as lower assumed separate account returns and lower assumed spreads on the guaranteed funds were partially offset by an increase in the take-up rate on guaranteed benefits – particularly guaranteed minimum withdrawal benefits.

The fixed index annuity new business margin decreased from 51 per cent in 2009 to 41 per cent in 2010 due to decreased spread assumptions and lower interest rates, offset somewhat by longer maturity contracts sold in 2010. These same interest rate and spread factors also caused the fixed annuity new business margin to normalise from 57 per cent to 34 per cent. For both products, the spread assumptions decreased due primarily to abnormally high investment yields during 2009.

Total EEV basis operating profit for the long-term business in 2010 was £1,458 million, compared to £1,233 million in 2009. In-force EEV profits of £697 million for 2010 were 22 per cent higher than 2009 profit of £569 million. During 2010, EEV basis operating profit benefited as a result of the interest rate swap transactions noted earlier. Including this benefit, experience variances and other items were £201 million higher in 2010 due primarily to favourable spread and persistency variances that were partially offset by lower expense and mortality variances.

In 2010, Jackson invested £300 million of free surplus to write £1,164 million of new business (2009: £326 million and £912 million, respectively). The reduction in capital consumption year-on-year was caused predominantly by the differing business mix in 2010, when Jackson wrote a higher proportion of variable annuity business, which consume lower levels of initial capital, while maintaining a disciplined approach to fixed and fixed index annuity pricing.

**UK operations**

| | AER | | | CER | |
|---|---|---|---|---|---|
| | **2010** | **2009** | **Change** | **2009** | **Change** |
| | **£m** | **£m** | **%** | **£m** | **%** |
| APE sales | **820** | 723 | 13 | 723 | 13 |
| NBP | **365** | 230 | 59 | 230 | 59 |
| NBP margin (% APE) | **45%** | 32% | | 32% | |
| Total IFRS operating profit | **719** | 657 | 9 | 657 | 9 |
| Total EEV basis operating profit | **982** | 921 | 7 | 921 | 7 |

**Introduction**

Prudential UK competes selectively in the UK's retirement savings and income market. The focus of the business is to balance writing profitable new business at attractive returns on capital with sustainable cash generation, which is key for the Group and capital preservation. It is this discipline that has enabled Prudential UK to deliver another strong performance in 2010.

The UK has a mature life and pensions market which is characterised by an ageing population - in particular, through two waves of baby-boomers born after World War II and in the 1960s - with wealth distribution significantly skewed and very much concentrated in the 45-74 age group. In this context, the retirement and near-retirement segments are highly attractive.

UK consumers are insufficiently prepared as they will have to face increasingly long periods of retirement. This will result in longer working lives and a more flexible approach towards retirement. It will also mean that the baby-boomers will need to target their wealth on the provision of dependable retirement income. Prudential UK's expertise in areas such as longevity risk management and multi-asset investment, together with its financial strength and strong brand, mean that the business is strongly positioned in the retirement planning space with a particular focus on with-profits and annuities.

**Business overview**

*Selective participation in the retirement income and savings market*

Prudential UK has a strong individual annuity business, built on a robust pipeline of internal vestings from maturing individual and corporate pension policies. The internal vestings pipeline is supplemented by sales through intermediaries and strategic partnerships with third parties where Prudential is the recommended annuity provider for customers vesting their pensions at retirement.

Total individual annuity sales of APE £205 million were six per cent lower than in 2009, mainly due to lower sales of conventional annuities where Prudential UK pro-actively managed the flow of new business to control capital consumption. This was partially offset by strong sales of with-profits annuities which represented 22 per cent of total annuity sales, compared with 15 per cent last year, due to the continuing success of the innovative Income Choice Annuity (ICA). The ICA is a with-profits product, launched in March 2009, which offers consumers security with a potential for income growth.

Internal vestings annuity sales of APE £124 million were nine per cent down on 2009, principally due to the number of customers retiring being lower than in 2009. Although fewer Prudential customers invested in conventional annuities, there continues to be a positive increase in the number of customers choosing an ICA, with sales of APE £16 million resulting in a 38 per cent increase in with-profits annuity sales.

Onshore bond sales of APE £166 million were up 15 per cent, including with-profits bond sales of APE £146 million which increased 11 per cent with an exceptionally strong fourth quarter. PruFund made up 78 per cent of our total with-profits bond sales. Demand for Prudential UK's with-profits products remains resilient and the business has continued to innovate to maintain and enhance its position in the market. This includes broadening access to PruFund across its retail savings product range and PruFund now has over £3 billion invested.

Unit-linked bond sales of APE £20 million were 61 per cent up on 2009, helped by the launch of PruDynamic portfolio funds in January 2010 and the continued success of the PruSelect fund range.

Individual pension sales of APE £69 million (including income drawdown) were three per cent up on 2009. Sales of the Flexible Retirement Plan, Prudential UK's RDR-compliant individual pension and income drawdown product, grew by four per cent to APE £22 million. PruFund Cautious, launched in the fourth quarter of 2009, and the new PruDynamic portfolio funds, launched in January 2010, together made up 34 per cent of individual pension sales.

Corporate pension sales of APE £221 million were five per cent above 2009 levels. Prudential UK administers corporate pensions for over 600,000 scheme members sponsored by some of the UK's largest employers and has also built a very strong position in the provision of with-profits Additional Voluntary Contribution (AVC) arrangements. Prudential UK provides AVCs to 66 of the 99 Local Government Authorities in England & Wales. During 2010, Prudential UK continued to focus on strengthening existing relationships through further improvements to online servicing capabilities as well as targeted marketing activity.

In August 2010, Prudential UK's joint venture partner Discovery SA announced the completion of the acquisition of Standard Life Healthcare and its combination with the PruHealth business. As part of the transaction, Prudential UK reduced its shareholding in the combined PruHealth and PruProtect businesses from 50 per cent to 25 per cent of the enlarged group and sales are included on a proportionate basis from 1 August 2010. PruProtect sales had previously been included at 100 per cent and PruHealth sales at 50 per cent. The effect of this reporting change is that Prudential UK's share of PruProtect sales is reported at APE £16 million, an increase of 18 per cent. Prudential UK's share of PruHealth sales of APE £12 million was nine per cent higher than in 2009 and at the end 2010, the combined health business covered approximately 680,000 lives.

*Capitalising on our competitive advantages*

The strength and investment performance of Prudential UK's With-Profits Fund is widely recognised in the industry and was demonstrated by the 12.7 per cent pre-tax investment return achieved for policyholder asset shares in the Fund in 2010. The Fund has delivered investment returns of 82.1 per cent over ten years, which compares favourably with other with-profits funds and the FTSE All-Share Index (total return) of 43.3 per cent over the same period. This strong performance has shown that with-profits, when invested in an actively managed, and financially strong fund like Prudential's, continues to be a very attractive medium to long-term investment, offering strong annualised returns compared with other investment options. Prudential's with-profits customers benefit from the security offered by Prudential's large inherited estate, with the free assets of the with-profits fund valued at approximately £6.8 billion at the year end, valued on a realistic basis.

In the Wholesale market, Prudential UK's aim is to continue to participate very selectively in bulk and back-book buyouts using its financial strength, superior investment track record and annuitant mortality risk assessment and servicing capabilities. In line with this approach, in the fourth quarter of 2010, Prudential UK signed a bulk annuity buy-in insurance agreement of £88 million APE.

*Building capabilities*

In September 2010, Prudential UK announced a five-year exclusive agreement with Santander to distribute its market-leading investment bonds in the UK. Prudential UK's Flexible Investment Plan, including PruFund, will be available to Santander's UK customers in 1,300 high street branches throughout the country.

This new agreement, which is expected to go live in the second half of 2011, forms part of Prudential UK's continuing strategy to develop diversified and complementary distribution across its Direct, Intermediary and Partnership channels.

Prudential UK's focus on delivering improved levels of customer service was recognised again at the 2010 Financial Adviser Service Awards, where it retained its 5-Star rating for excellent service in the Investment category.

**Financial performance**

Retail APE sales of £725 million were up one per cent on 2009, with the new business margin increasing from 31 per cent to 35 per cent. This performance was entirely consistent with Prudential UK's strategy of not pursuing top-line sales growth but instead deploying capital to opportunities that play to the core strengths of the business and generate the best returns.

Total APE sales increased by 13 per cent to £820 million and included the bulk annuity buy-in insurance agreement. This transaction generated EEV new business profit of £104 million and £63 million of IFRS operating profits of £63 million. Prudential UK will continue to maintain a very strict focus on value and only participate in capital-efficient transactions that meet its strict return on capital requirements. Including this transaction, Prudential UK's new business margin increased from 32 per cent to 45 per cent.

Higher sales and margins resulted in total EEV new business profits increasing by 59 per cent to £365 million. This improvement included the impact of the bulk annuity transaction, but also reflected improved retail margins, in particular on with-profits bonds. Retail EEV new business profits at £257 million were 15 per cent up on 2009 (£223 million).

IFRS total operating profits before restructuring costs were up nine per cent at £719 million, reflecting increased sales. Commission received on Prudential-branded General Insurance products contributed £46 million to IFRS operating profits in 2010, £5 million lower than 2009 as the book of business originally transferred to Churchill in 2004 is decreasing as expected.

EEV total operating profit of £982 million was up seven per cent mainly due to an increase in new business profits. In-force EEV operating profit included £37 million from renewal expense assumptions and £41 million from the change in the long-term tax rate assumption from 28 per cent to 27 per cent. These positive impacts were offset by a £40 million negative net impact from the strengthening of mortality improvement assumptions, partially offset by the release of excess margins previously held.

Prudential UK continues to manage actively the retention of the in-force book. During 2010, the experience at an aggregate level has been in line with long-term assumptions.

Prudential UK writes with-profits annuity, with-profits bond and with-profits corporate and individual pensions business in its Life Fund, with other products backed by shareholder capital. The weighted average post-tax IRR on the shareholder capital allocated to new business in the UK was in excess of 20 per cent. The average free surplus undiscounted payback period for shareholder backed business written in 2010 was four years.

As announced at the half-year, the business met its cost savings target of £195 million per annum, six months early. Prudential UK has commenced a number of cost saving initiatives to reduce costs by a further £75 million per annum on a consistent basis by the end of 2013. The business has already made good progress towards this objective in 2010.

During 2010 Prudential UK remitted cash of £420 million to the Group, comprising £202 million from the annual with-profits transfer to shareholders and £218 million from the shareholder backed business, which included £120 million from one-off releases of surplus and net financing repayments. The business expects to generate £350 million per annum sustainable cash remittances by 2013, supported by the strength of the with-profits business and surpluses arising from the large book of shareholder backed annuities, maintained into the future by the pipeline of maturing individual and corporate pensions.

## M&G

| | | AER | | CER | |
|---|---|---|---|---|---|
| | **2010** | **2009** | **Change** | **2009** | **Change** |
| | **£m** | **£m** | **%** | **£m** | **%** |
| Net investment flows | **9,105** | 13,478 | (32) | 13,478 | (32) |
| Revenue | **612** | 457 | 34 | 457 | 34 |
| Other income | **3** | 13 | (77) | 13 | (77) |
| Staff costs | **(263)** | (205) | (28) | (205) | (28) |
| Other costs | **(123)** | (100) | (23) | (100) | (23) |
| Underlying profit before performance-related fees | **229** | 165 | 39 | 165 | 39 |
| Performance-related fees | **17** | 12 | 42 | 12 | 42 |
| Operating profit from asset management operations | **246** | 177 | 39 | 177 | 39 |
| Operating profit from Prudential Capital | **38** | 61 | (38) | 61 | (38) |
| Total IFRS operating profit | **284** | 238 | 19 | 238 | 19 |
| Funds under management | **198bn** | 174bn | 14 | 174bn | 14 |

### Introduction

M&G is the UK and European fund manager of the Prudential Group with responsibility for £198 billion of investments as at 31 December 2010 on behalf of both internal and external clients. M&G is an investment-led business whose aim is to generate superior long-term returns for its third party investors and the internal funds of the Prudential Group.

This aim is achieved by creating an environment that is attractive to investment talent. The core focus on investment performance, combined with a well-diversified business mix and established distribution capabilities, has helped M&G achieve strong net sales performance, growth in funds under management and increased profitability.

In the retail market, M&G's aim is to operate a single fund range and to diversify the distribution base by accessing a wide variety of channels and geographies. In recent years, key themes have included growing the proportion of business sourced from intermediated channels and the increased sales of UK-based funds in European and other international markets.

In the institutional marketplace, M&G's approach centres on leveraging capabilities developed primarily for the Prudential internal funds to create higher margin external business opportunities. This has allowed M&G to offer third-party clients an innovative range of specialist fixed income strategies, including leveraged finance and infrastructure investment.

### Sales performance

2009 was an exceptional year for M&G in terms of net sales. The Retail business experienced unprecedented net purchases of its top-performing bond funds by investors seeking to exploit a near unique opportunity in fixed income markets. On the institutional side, M&G benefited in particular from winning a very substantial single institutional mandate. It was not expected that the business would be able to repeat these levels of net sales in 2010. In the event, the Retail business achieved full year net inflows of £7.4 billion, a decrease of only one per cent compared to the record level of £7.5 billion in 2009. On the institutional side, M&G still achieved very healthy net sales of £1.7 billion.

Gross fund inflows for the full year rose six per cent to £26.4 billion. This set a new record for the M&G business, surpassing the £24.9 billion achieved in 2009. Maintaining this strong sales performance over 2010, and in some highly volatile markets, demonstrates M&G's strength in depth across all the main asset classes and distribution channels.

M&G's Retail business in the UK has been number one for gross and net retail sales over nine consecutive quarters based on data to the end of December 2010[1]. As already highlighted, it was sales of M&G's top-performing fixed income funds that accounted for the lion's share of net inflows in 2009 with 68 per cent of the net retail flows. During 2010, fixed income products continued to sell extremely well, accounting for 43 per cent of flows, but, with market sentiment turning more bullish, investor appetite for our equity and property funds increased. Net inflows into equity funds have increased in share from 26 per cent in 2009 to 48 per cent of total net retail sales in 2010. Over the same period, property funds' share of total net sales trebled to nine per cent.

The improved diversification of sales by asset class was matched by an increased diversification of sales performance by region. In 2009, 19 per cent of net retail flows were from M&G's distribution business outside of the UK, primarily based in Europe. This figure had increased to 39 per cent by the end of 2010.

The retail investment market in Europe is substantially larger than the UK market. In further response to this opportunity, M&G's European Retail business registered its core OEIC fund range for distribution in the Netherlands and Sweden in the fourth quarter of 2010. Registration in both markets has already boosted sales results with M&G being able to leverage off existing client relationships established in other European markets. M&G already has a proven track record of success in distributing into Europe with its registration in France in 2007, for example, having already generated funds under management of £1.3 billion and achieved status as a top ten cross border player in the French market[2]. Total funds under management sourced outside of the UK amounted to £13.4 billion at the end of 2010, equivalent to 31 per cent of total retail external funds managed by M&G.

The consistency and excellence of its performance resulted in M&G being awarded the prestigious 2010 Global Group of the Year award at the 15th annual *Investment Week* Fund Manager of the Year Awards. This is the second time in three years that M&G has received this award.

In the institutional market, M&G also attracted healthy net new business on the back of outstanding investment performance with inflows of £1.7 billion. This compares with net inflows of almost £6.0 billion in 2009, although this latter figure was dominated by a single £4 billion fixed income mandate. Like M&G's retail distribution, the institutional business also benefits from an increasingly diverse investor base with distribution activities covering Scandinavia and the Netherlands.

M&G's institutional business was also recognised for its investment performance winning the 2010 UK Asset Management Firm of the Year award at *Financial News'* Awards for Excellence in Institutional Asset Management.

M&G's total funds under management at 31 December 2010 were at a record level of £198.3 billion, up 14 per cent on the 2009 year end. External funds under management at the end of 2010 of £89.3 billion were 27 per cent higher than the start of the year and now represent 45 per cent of M&G's total funds under management.

**Financial performance**

M&G's IFRS operating profit rose to £246 million, an increase of 39 per cent compared with the 2009 result of £177 million.

The full year 2010 result was a record profit level for M&G, being eight per cent higher than the previous record achieved in 2008. If performance-related fees and carried interest on private equity investments are excluded, M&G's operating profit would actually display underlying growth of 24 per cent over 2008. Equity market levels have boosted business results, with the FT All Share averaging three per cent higher over 2010 compared to 2008. It is also the exceptionally strong net inflows over 2009 and 2010, particularly from the Retail business that have contributed to the increased profit levels.

[1] Source: Fundscape Pridham Report
[2] Source: Lipper FMI Saleswatch

M&G remains focused on cost control with the cost/income ratio[1] at 63 per cent over the full year, an improvement on the 2009 result of 65 per cent. A key aspect to cost management is to create a more flexible operational cost base, where appropriate, to enable the business to react to significant changes in its business profile. During 2010, M&G outsourced fund accounting, taxation and pricing operations for its UK regulated retail funds to an external supplier. The transition of these services has secured for M&G access to a scalable global platform to support both the current and future needs of its funds. Outsourcing this element of its operational platform to a dedicated provider of these services also ensures that M&G can focus on the continued delivery of strong investment performance and winning new business.

M&G continues to provide capital efficient profits and cash generation for the Prudential Group, as well as strong investment returns on the internally managed funds. Cash remittances of £150 million in 2010 provided strong support for the Group's corporate objectives.

## Prudential Capital

Prudential Capital (PruCap) manages Prudential Group's balance sheet for profit by leveraging Prudential Group's market position. This business has three strategic objectives: to provide professional treasury services to the Prudential Group; to operate a first-class wholesale and capital markets interface; and to realise profitable proprietary opportunities within a tightly controlled risk framework. PruCap generates revenue by providing bridging finance, managing investments and operating a securities lending and cash management business for the Prudential Group and its clients.

The business has consolidated its position in a period of difficult and volatile markets, focusing on liquidity across the Prudential Group, management of existing asset portfolio and conservative levels of new investment. Development of new product and infrastructure has continued, helping to maintain the dynamism and flexibility necessary to identify and realise opportunities for profit within acceptable risk parameters. PruCap is committed to continuing to work closely with other business units across the Prudential Group to exploit opportunities and increase value creation for Prudential as a whole. In particular, PruCap offers to the Prudential Group a holistic view on hedging strategy, liquidity and capital management.

PruCap has a diversified earnings base derived from its portfolio of secured loans, debt investments and the provision of wholesale markets services. As a result of lower net operating revenue and prevailing market conditions, IFRS operating profits decreased by 38 per cent to £38 million, however PruCap still delivered a cash remittance to the Group holding company of £52 million.

[1] Excluding performance related fees and carried interest on private equity investments

## Asia asset management

| | AER | | | CER | |
|---|---|---|---|---|---|
| | **2010** | **2009** | **Change** | **2009** | **Change** |
| | **£m** | £m | % | £m | % |
| Retail and institutional business net inflows | **1,838** | 556 | 231 | 569 | 223 |
| Money Market Funds net (outflows)/inflows (MMF) | **(2,053)** | 1,443 | (242) | 1,550 | (232) |
| Funds under management | **51.9bn** | 42.4bn | 22 | 47.2bn | 10 |
| Total IFRS operating profit | **72** | 55 | 31 | 58 | 24 |

### Introduction

Prudential's asset management business in Asia manages investments for UKIO and the Asian life companies and has also successfully leveraged these investment capabilities to build a strategically significant and market leading third party funds management business.

### Business overview

Under the leadership of a new Chief Executive, the team has driven strong improvements in the business.

Investment performance is a key driver of success and for 2010, 68 per cent of our funds outperformed their peer medians or benchmarks[1]. Accolades received during the year included the PCA Indonesia Equity Open Fund being recognised as 'Fund of the Year 2010' in Japan by Morningstar amongst 557 open-ended funds in the domestic market, as well as the PCA China Dragon A-share Equity fund being named 'Best fund in overseas equity category' in Korea's 2010 MoneyToday - Morningstar Fund Awards. In India and China, funds offered by our joint venture businesses were ranked top-decile by their respective local rating agencies.

The business has been actively implementing its strategy of targeting higher-margin equity and bond asset classes. Third party net inflows of £1.8 billion were driven predominantly by Japan, which saw strong interest for its white-labelled Asia Oceanic High Dividend Equity and its open-ended Indonesian Equity Open funds. In addition, positive bond fund flows resulted from Taiwan and China's successful new product launches and strong demand for our offshore product range. Money market funds saw net outflows totalling £2.1 billion in 2010, mainly attributed to redemptions in India as a result of tighter liquidity conditions.

### Financial performance

Prudential's Asian asset management business' total FUM crossed the £50 billion mark for the first time and closed the year at £52 billion which includes a core £25 billion from Prudential Corporation Asia's life funds, £5 billion of assets from the Group and £22 billion from third-party customers. Compared to 2009, the overall FUM increased by 22 per cent, driven by net inflows of £1.8 billion and a total of £7.7 billion of positive market and currency related movements.

IFRS operating profit from fund management of £72 million is 31 per cent higher than in the prior year. The Funds business remitted a net £33 million of surplus capital to the Group during 2010.

[1] Based on a blend of 1-year and 3-year performance.

## US asset management

### *PPM America*

| | AER | | | CER | |
|---|---|---|---|---|---|
| | **2010** | **2009** | **Change** | **2009** | **Change** |
| | **£m** | **£m** | **%** | **£m** | **%** |
| Total IFRS operating profit | **10** | 6 | 67 | 5 | 100 |

**Business overview**

PPM America (PPMA) manages assets for Prudential's US, UK and Asian affiliates. PPMA also provides other affiliated and unaffiliated institutional clients with investment services including collateralised debt obligations (CDOs), private equity funds, institutional accounts, and mutual funds. PPMA's strategy is focused on managing existing assets effectively, maximising the benefits derived from synergies with our international asset management affiliates, and leveraging investment management capabilities across the Prudential Group. PPMA also pursues third-party mandates on an opportunistic basis.

**Financial performance**

IFRS operating profit in 2010 was £10 million, compared to £6 million in 2009.

At 31 December 2010, funds under management of £54 billion were as follows:

| | AER | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **2010** | | | | **2009** | | | |
| | **US** | **UK** | **Asia** | **Total** | **US** | **UK** | **Asia** | **Total** |
| | **£bn** | **£bn** | **£bn** | **£bn** | **£bn** | **£bn** | **£bn** | **£bn** |
| Insurance | 31 | 15 | - | 46 | 29 | 12 | - | 41 |
| Unitised | 1 | 1 | 5 | 7 | - | 1 | 4 | 5 |
| CDOs | 1 | - | - | 1 | 1 | - | - | 1 |
| **Total funds under management** | **33** | **16** | **5** | **54** | 30 | 13 | 4 | 47 |

### *Curian*

| | AER | | | CER | |
|---|---|---|---|---|---|
| | **2010** | **2009** | **Change** | **2009** | **Change** |
| | **£m** | **£m** | **%** | **£m** | **%** |
| Gross investment flows | **1,361** | 796 | 71 | 806 | 69 |
| Revenue | **39** | 25 | 56 | 26 | 50 |
| Costs | **(38)** | (31) | 23 | (32) | 19 |
| Total IFRS operating profit/(loss) | **1** | (6) | 117 | (6) | 117 |
| Total funds under management | **3,457** | 2,260 | 53 | 2,331 | 48 |

**Business overview**

Curian Capital, Jackson's registered investment advisor, provides innovative fee-based managed accounts and investment products to advisers through a sophisticated technology platform. Curian expands Jackson's access to advisers while also complementing Jackson's core annuity product lines with Curian's retail asset management products.

**Financial performance**

At 31 December 2010, Curian had total assets under management of £3.5 billion, compared to £2.3 billion at the end of 2009. Curian generated deposits of £1,361 million in 2010, up 71 per cent over 2009. The increase in both deposits and assets under management was mainly due to an expansion of Curian's investment platform with the addition of two new investment strategies, plus an expansion of the firm's wholesaling team, in addition to a rebound from the difficult conditions in the equity markets in early 2009.

Curian's assets under management surpassed the break-even point during the year, resulting in the firm reporting its first full-year IFRS basis operating profit in 2010, with a net profit of £1 million versus a loss of £6 million during 2009.

***US Broker dealer***

***National Planning Holdings, Inc.***

| | AER | | | CER | |
|---|---|---|---|---|---|
| | **2010 £m** | **2009 £m** | **Change %** | **2009 £m** | **Change %** |
| Revenue | **449** | 390 | 15 | 395 | 14 |
| Costs | **(438)** | (386) | 13 | (391) | 12 |
| Total IFRS operating profit | **11** | 4 | 175 | 4 | 175 |

**Business overview**

National Planning Holdings, Inc. (NPH) is Jackson's affiliated independent broker-dealer network. The business is comprised of four broker-dealer firms, including INVEST Financial Corporation, Investment Centers of America, National Planning Corporation, and SII Investments.

NPH continues to grow the business and revenue per representative. By utilising high-quality, state-of-the-art technology, we provide NPH's advisers with the tools they need to operate their practices more efficiently. At the same time, through its relationship with NPH, Jackson continues to benefit from an important retail distribution outlet, as well as receive valuable insights into the needs of financial advisers and their clients.

**Financial performance**

NPH generated revenues of £449 million in 2010, up from £390 million in 2009, on gross product sales of £9.3 billion. The network continues to achieve profitable results, with 2010 IFRS operating profit of £11 million, a 175 per cent increase from £4 million in 2009. At 31 December 2010, the NPH network had 3,461 registered advisers, down slightly from 3,478 at year-end 2009.

## FINANCIAL REVIEW

## RESULTS SUMMARY

### International financial reporting standards (IFRS) basis results*

| **Statutory IFRS basis results** | **2010** | **2009** |
|---|---|---|
| Profit after tax attributable to equity holders of the Company | **£1,431m** | £676 m |
| Basic earnings per share | **56.7 p** | 27.0 p |
| Shareholders' equity, excluding non-controlling interests | **£8.0bn** | £6.3 bn |

| **Supplementary IFRS basis information** | **2010** | **2009 (i)** |
|---|---|---|
| | **£m** | **£m** |
| Asian operations | **604** | 465 |
| US operations | **855** | 622 |
| UK operations: | | |
| UK insurance operations | **719** | 657 |
| M&G | **284** | 238 |
| Other income and expenditure | **(450)** | (395) |
| Restructuring and Solvency II implementation costs | **(71)** | (23) |
| **Operating profit based on longer-term investment returns*(i)** | **1,941** | 1,564 |
| Short-term fluctuations in investment returns on shareholder-backed business | **(123)** | (123) |
| Shareholders’ share of actuarial and other gains and losses on defined benefit pension schemes | **(10)** | (74) |
| Costs of terminated AIA transaction | **(377)** | - |
| Gain on dilution of holding in PruHealth | **30** | - |
| Loss on sale and results of Taiwan agency business | **-** | (621) |
| Profit from continuing operations before tax attributable to shareholders | **1,461** | 746 |
| Operating earnings per share*(ii) | **62.0 p** | 47.5 p |

### European embedded value (EEV) basis results*

| | **2010** | **2009** |
|---|---|---|
| | **£m** | **£m** |
| Asian operations | **1,518** | 1,154 |
| US operations | **1,480** | 1,237 |
| UK operations: | | |
| UK insurance operations | **982** | 921 |
| M&G | **284** | 238 |
| Other income and expenditure | **(494)** | (433) |
| Restructuring and Solvency II implementation costs | **(74)** | (27) |
| **Operating profit based on longer-term investment returns*** | **3,696** | 3,090 |
| Short-term fluctuations in investment returns | **(30)** | 351 |
| Mark to market value movements on core borrowings | **(164)** | (795) |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | **(11)** | (84) |
| Effect of changes in economic assumptions | **(10)** | (910) |
| Costs of terminated AIA transaction | **(377)** | - |
| Gain on dilution of holding in PruHealth | **3** | - |
| Profit on sale and results of Taiwan agency business | **-** | 91 |
| **Profit from continuing operations before tax (including actual investment returns)** | **3,107** | 1,743 |
| Operating earnings per share*(ii) | **106.9 p** | 88.8 p |
| Shareholders' equity, excluding non-controlling interests | **18.2bn** | 15.3bn |

| | **2010** | **2009** |
|---|---|---|
| **Dividends per share declared and paid in reporting period** | **20.17 p** | 19.20 p |
| **Dividends per share relating to reporting period** | **23.85 p** | 19.85 p |
| **Funds under management** | **£340bn** | £290bn |
| **Insurance Groups Directive capital surplus (as adjusted)*** | **£4.3bn** | £3.4bn |

(i) The Company has amended the presentation of IFRS operating profit for its US insurance operations to remove the net equity hedge accounting effect (incorporating related amortisation of deferred acquisition costs) and include it in short-term fluctuations. The 2009 amounts have been amended accordingly. As explained overleaf and in Note C to the IFRS financial statements.

(ii) Operating earnings per share reflects operating profit based on longer-term investment returns after related tax and non-controlling interests but excludes in 2010 an exceptional tax credit of £158 million which primarily relates to the impact of a settlement agreed with the UK tax authorities.

*     <u>**Basis of preparation**</u>

***Results bases***

*With the exception of the adoption of IFRS 3 (Revised) on business combinations and associated amendments to other standards and the altered basis of presentation for Jackson's IFRS operating profit referred to below the basis of preparation of the statutory IFRS basis results and supplementary IFRS basis information is consistent with that applied for the 2009 results and financial statements.*

*The EEV basis results have been prepared in accordance with the European Embedded Value Principles issued by the CFO Forum of European Insurance Companies in May 2004. Life insurance products are, by their nature, long-term and the profit on this business is generated over a significant number of years. Accounting under IFRS alone does not, in Prudential's opinion, fully reflect the value of future profit streams. Prudential considers that embedded value reporting provides investors with a measure of the future profit streams of the Group's in-force long-term businesses and is a valuable supplement to statutory accounts. With the exception of the presentation of the new business results of the Japan life operation which ceased writing new business in February 2010 there has been no change to the basis of presentation of the EEV results from the 2009 results and financial statements.*

***Exchange translation – Actual Exchange Rate (AER) and Constant Exchange Rate (CER)***
*The comparative results have been prepared using previously reported exchange rates (AER basis) except where otherwise stated.*

***Operating profit based on longer-term investment returns***
*Consistent with previous reporting practice, the Group provides supplementary analysis of IFRS profit before tax attributable to shareholders and analyses its EEV basis results, so as to distinguish operating profit based on longer-term investment returns from other elements of total profit. On both the IFRS and EEV bases, operating earnings per share are calculated using operating profits based on longer-term investment returns, after related tax and non-controlling interests.*

*These profits exclude short-term fluctuations in investment returns and the shareholders' share of actuarial and other gains and losses on defined benefit pension schemes. The operating profit based on longer-term investment returns for 2010 also excludes the costs associated with the terminated AIA transaction and the gain arising upon the dilution of the Group's holding in PruHealth. Consistent with the prior year presentation, the effect of disposal and the results of the Taiwan agency business are shown separate from operating profit based on longer-term investment returns for 2009.*

*In 2010 the Company amended its presentation of IFRS operating profit for its US insurance operations to exclude the net equity hedge accounting effect of negative £367 million (2009: negative £159 million) relating principally to its variable annuity business and reclassified it as a short-term fluctuation. Prior year comparatives have been amended accordingly. This is a presentational change and it has no impact on the IFRS profit before tax or the IFRS shareholders' funds. The change also has no impact on our EEV financial statements.*

*Under the EEV basis, where additional profit and loss effects arise, operating profit based on longer-term investment returns also excludes the mark to market value movements on core borrowings and the effect of changes in economic assumptions.*

*After adjusting for related tax and non-controlling interests, the amounts excluded from operating profit based on longer-term investment returns are included in the calculation of basic earnings per share.*

***Insurance Groups Directive capital surplus (as adjusted)***
*The surpluses shown for 2010, which is estimated, and 2009 are before allowing for the final dividends for 2010 and 2009 respectively.*

**IFRS RESULTS**

**IFRS basis operating profit based on longer-term investment returns**

| | | AER | | CER | |
|---|---|---|---|---|---|
| | **2010** | **2009** | **Change** | **2009** | **Change** |
| | **£m** | **£m** | **%** | **£m** | **%** |
| Insurance business | | | | | |
| Long-term business: | | | | | |
| Asia | **536** | 416 | 29 | 451 | 19 |
| US[(a)] | **833** | 618 | 35 | 626 | 33 |
| UK | **673** | 606 | 11 | 606 | 11 |
| Development expenses | **(4)** | (6) | 33 | (6) | 33 |
| **Long-term business operating profit** | **2,038** | 1,634 | 25 | 1,677 | 22 |
| UK general insurance commission | **46** | 51 | (10) | 51 | (10) |
| Asset management business: | | | | | |
| M&G | **284** | 238 | 19 | 238 | 19 |
| Asia asset management | **72** | 55 | 31 | 58 | 24 |
| Curian | **1** | (6) | 117 | (6) | 117 |
| US broker-dealer and asset management | **21** | 10 | 110 | 10 | 110 |
| | **2,462** | 1,982 | 24 | 2,028 | 21 |
| Other income and expenditure | **(450)** | (395) | 14 | (396) | 14 |
| Solvency II implementation costs | **(45)** | - | 100 | - | 100 |
| Restructuring costs | **(26)** | (23) | 13 | (23) | 13 |
| **Total IFRS basis operating profit based on longer-term investment returns**[(a)] | **1,941** | 1,564 | 24 | 1,609 | 21 |

(a) The Company has amended the presentation of IFRS operating profit for its US insurance operatives to remove the net equity hedge accounting effect (incorporating related amortisation of deferred acquisition costs) and include it in short-term fluctuations. 2009 amounts have been amended accordingly.

Group IFRS operating profit before tax based on longer-term investment returns after Solvency II implementation and restructuring costs was £1,941 million, an increase of 24 per cent on 2009.

In Asia, IFRS operating profit for long-term business increased by 29 per cent from £416 million in 2009 to £536 million in 2010, with the £416 million in 2009 being inclusive of a £63 million one-off credit relating to changes to the Malaysia reserving basis. Profits from in-force business grew by 20 per cent from £494 million in 2009 to £593 million in 2010 reflecting the continued build-up of the business in the region and the positive impact of currency fluctuations. New business strain of £56 million[1] (2009: £72 million) was 3.7 per cent of APE new business sales, a significant improvement compared to last year (2009: 6.0 per cent[1]) demonstrating management's continued focus on capital efficient growth.

There was a continued strong performance across the Asian region. Hong Kong, Singapore, Malaysia and Indonesia accounted for 81 per cent or £434 million of operating profits (2009: £390 million, including the impact of the one-off credit recorded in Malaysia). Strong underlying improvements were reported in Indonesia with operating profits higher by 54 per cent to £157 million reflecting both the success of our product offering and the growing maturity of this business. Malaysia operating profits, excluding the one-off credit in 2009, were also higher by 49 per cent to £97 million reflecting the growing size of our book of business and the strong earnings profile of our health and protection business. The contribution to IFRS profits from the other Asian businesses is also improving. The closure of Japan to new business has substantially reduced the IFRS losses of this business and Taiwan saw an improvement in the year as it refocused on bancassurance business. Korea benefited from improved in-force profits in the period and Vietnam was up 43 per cent to £43 million. Changes to reserving bases in India and China contributed a £19 million one-off profit, with both countries showing improvement in their underlying results excluding this change.

[1] Excluding Japan which ceased writing new business in 2010. IFRS new business strain including Japan was £57 million (2009: £78 million).

The US long-term business operating profit increased by 35 per cent from £618 million in 2009 to £833 million in 2010, reflecting strong growth in spread and fee income, up £195 million and £182 million respectively, as Jackson's policyholder liability balances grew. Jackson undertook various transactions in 2010 to more closely match the overall asset and liability duration. This contributed £108 million to operating profit in the period. These positive contributions to profits have been partially offset by increased costs and DAC amortisation primarily reflecting Jackson's growth.

Jackson's operating profit net of related DAC amortisation excludes the net equity hedge accounting effect of negative £367 million (2009: negative effect of £159 million) following a change in the presentation of operating profit based on longer-term investment returns. Jackson's hedging approach has always focused on optimising the economic outcome ahead of accounting results, which means we accept an element of variability in accounting outcomes in order to ensure we achieve the right economic result. We believe this presentational change, which reclassifies net equity hedge accounting effects as short-term fluctuations in investment returns, will ensure that Jackson's operating results better reflect its unchanged and continued focus on optimising economic value.

Accounting volatility previously arose within the reported IFRS operating profit due to the difference between the movement in the fair value of free standing derivatives within Jackson's equity hedging programme for annuity business and the movement in the accounting value of Jackson's liabilities for variable and fixed index annuity guarantees. Typically, under IFRS, reserves are not fair valued, which for the US variable annuities business produces a distorting accounting effect on the IFRS operating profit that is not representative of the true economics of Jackson's hedging programme. Jackson's economically based hedges are marked to market. As a result, when the marked to market value of the hedges changes, there are offsetting changes in the economic value of the hedged liabilities which are not reflected in our accounts. This is particularly relevant for the Guaranteed Minimum Death Benefit (GMDB) and the Guaranteed Minimum Withdrawal Benefit (GMWB) with 'for-life' features. This mismatch creates additional short-term volatility in our profit which does not reflect changes in the underlying economic position.

Over the long-term the impact of this accounting distortion should cumulatively net out to a broadly neutral effect, but in the short-term the impact to the IFRS total profit can be highly volatile. The recent growth in Jackson's variable annuity business has resulted in this short-term effect having a greater impact on our IFRS operating profit than in prior years. In the 2010 half year financial statements this accounting mis-match produced a positive contribution to the IFRS operating profit of £123 million for the first six months as compared to a negative contribution of £367 million for the full year.

In our UK business, total IFRS operating profit grew by nine per cent to £719 million in 2010 reflecting higher retail profits and the bulk annuity transaction agreed in the last quarter of 2010. Profit from UK general insurance commission decreased by £5 million to £46 million in 2010 in line with the decline in the in-force policy numbers as the business matures.

M&G's operating profit for 2010 was £284 million, an increase of 19 per cent from £238 million in 2009, primarily reflecting the continuation of exceptionally strong net inflows, including increased sales of higher margin equity products, and higher equity market levels. In 2010 M&G had net inflows of £9.1 billion, the second highest annual level of flows after 2009.

The Asian asset management operations reported operating profits of £72 million, up by 31 per cent from £55 million in 2009, driven by increased operating revenues as a result of higher funds under management (FUM). Strong net inflows for retail and institutional business of £1.8 billion together with positive market and currency movements have contributed to a 22 per cent increase in FUM (including internal funds) to £52 billion at the end of 2010.

The £55 million increase in the charge for other income and expenditure to £450 million primarily reflects an increase in interest payable on core structural borrowings.

We incurred £45 million of Solvency II implementation costs in 2010.

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

| | **2010** | | | AER 2009(i) | | | CER 2009(i) | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Operating profit £m** | **Average liability £m** | **Margin(ii) bps** | Operating profit £m | Average liability £m | Margin(ii) bps | Operating profit £m | Average liability £m | Margin(ii) bps |
| Spread income | **1,013** | **53,858** | **188** | 753 | 51,000 | 148 | 762 | 49,735 | 153 |
| Fee income | **688** | **57,496** | **120** | 458 | 43,373 | 106 | 469 | 43,153 | 109 |
| With-profits | **342** | **89,693** | **38** | 310 | 84,063 | 37 | 311 | 83,964 | 37 |
| Insurance margin | **592** | | | 448 | | | 466 | | |
| Margin on revenues | **1,241** | | | 1,041 | | | 1,112 | | |
| Expenses | | | | | | | | | |
| Acquisition costs(iii) | **(1,674)** | **3,492** | **(48)%** | (1,487) | 2,896 | (51)% | (1,547) | 2,947 | (52)% |
| Administration expenses | **(924)** | **111,354** | **(83)** | (814) | 94,373 | (86) | (844) | 92,888 | (91) |
| DAC adjustments | **518** | | | 614 | | | 628 | | |
| Expected return on shareholder assets | **242** | | | 248 | | | 250 | | |
| Non-recurrent release of reserve for Malaysia Life | **-** | | | 63 | | | 70 | | |
| **Operating profit** | **2,038** | | | 1,634 | | | 1,677 | | |

(i) The Company has amended the presentation of IFRS operating profit for its US insurance operations to remove the net equity hedge accounting effect (incorporating related amortisation of deferred acquisition costs) and include it in short term fluctuations. 2009 amounts have been amended accordingly.
(ii) Margin represents the operating return earned in the period as a proportion of the relevant class of policyholder liabilities excluding unallocated surplus. Opening and closing policyholder liabilities have been used to derive an average balance for the period.
(iii) Acquisition cost ratio represents shareholder acquisition costs as a percentage of total APE, including Japan APE new business sales of £7 million (2009: £52 million).

*Spread income* has increased by £260 million to £1,013 million, an increase of 35 per cent. This is higher than the six per cent increase in average liabilities, leading to an increase in margin, from 148 bps in 2009 to 188 bps in 2010. The increase in spread income arises primarily in the US, where investment spread has increased by £168 million. This reflects transactions in the period to more closely match the overall asset and liability duration in 2010, with an overall impact of £108 million, as well as decreased crediting rates on fixed annuities.

*Fee income* have increased by £230 million to £688 million. This principally reflects improved equity market performance and net cash inflows into unit linked liabilities of £6.7 billion during 2010, equivalent to an increase on opening liabilities of 13 per cent. The increase in fee margin from 106 bps to 120 bps reflects a richer mix of the higher fee variable annuity business.

*Insurance margin* has increased £144 million to £592 million in 2010. This increase is driven by growth in the in-force book in Asia which has a relatively high proportion of risk-based products.

*Margin on revenues* principally comprises amounts deducted from premiums to cover acquisition costs and administration expenses and has increased by 19 per cent from £1,041 million in 2009 to £1,241 million in 2010. This is driven by the growth of the business in Asia.

*Acquisition costs* have increased in absolute terms by £187 million to £1,674 million in 2010, but as percentage of APE new business sales they have fallen from 51 per cent in 2009 to 48 per cent in 2010. This is primarily due to Asia’s continuing improvements to new business strain, and in the US a move away from up front commission to on-going asset based commission, which is treated as an administration expense.

*Administration expenses* have increased by £110 million to £924 million in 2010 reflecting the growth of the business in the year. Overall the margin in 2010 is 83 bps, lower than the prior year margin of 86 bps.The improvement in this margin reflects operational leverage benefits in Asia and UK cost savings which have more than offset the effect of the move towards asset based commission in the US as described above.

*DAC adjustments* represents the level of costs deferred in the year offset by amortisation in the period. The year-on-year movement reflects changes in business mix and, in part, the acceleration of DAC amortisation in US.

**IFRS basis results - Analysis of asset management pre-tax IFRS operating profit based on longer-term investment returns**

| | 2010 | | | | |
|---|---|---|---|---|---|
| | **M&G** | **Asia** | **PruCap** | **US** | **Total** |
| | **£m** | **£m** | **£m** | **£m** | **£m** |
| **Operating income*** | **632** | **191** | **88** | **229** | **1,140** |
| **Operating profit based on longer-term investment returns** | **246** | **72** | **38** | **22** | **378** |
| **Average funds under management (FUM)**** | **£186.5bn** | **£47.2bn** | | | |
| **Margin based on operating income**** | **34 bps** | **40 bps** | | | |
| **Cost / income ratio***** | **63%** | **64%** | | | |

| | 2009 | | | | |
|---|---|---|---|---|---|
| | M&G | Asia | PruCap | US | Total |
| | £m | £m | £m | £m | £m |
| Operating income* | 482 | 160 | 89 | 183 | 914 |
| Operating profit based on longer-term investment returns | 177 | 55 | 61 | 4 | 297 |
| Average funds under management (FUM)** | £157.5bn | £39.6bn | | | |
| Margin based on operating income** | 31 bps | 40 bps | | | |
| Cost / income ratio*** | 65% | 67% | | | |

* Operating income is net of commissions and includes performance related fees.
**Margin represents operating income as a proportion of the related funds under management (FUM). Opening and closing FUM have been used to derive the average.
***Cost /income ratio is calculated as cost as a percentage of income excluding performance-related fees.

M&G increased its asset management fee margin during the year from 31 bps in 2009 to 34 bps in 2010. This reflects increased sales of higher margin equity funds in the year.

Asia maintained its margin at 40 bps from 2009 to 2010. This is driven by an improvement in the retail margin following positive inflows into higher margin equity and bond funds, offset by a decline in institutional margin caused by net outflows of money market funds.

PruCap’s operating profit fell during 2010 reflecting market conditions and higher funding costs.

The increase in US asset management operating income principally arises in PPMA reflecting increased performance fees and higher management fees.

**IFRS basis profit after tax**

| | AER | |
|---|---|---|
| | **2010** | **2009** |
| | **£m** | **£m** |
| **Operating profit based on longer-term investment returns** | **1,941** | 1,564 |
| Short-term fluctuations in investment returns:(i) | | |
| Insurance operations | **(148)** | 7 |
| IGD hedge costs | **-** | (235) |
| Other operations | **25** | 105 |
| | **(123)** | (123) |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | **(10)** | (74) |
| Costs of terminated AIA transaction | **(377)** | - |
| Gain on dilution of holding in PruHealth | **30** | - |
| Loss on sale and results of Taiwan agency business | **-** | (621) |
| **Profit before tax from continuing operations attributable to shareholders** | **1,461** | 746 |
| Tax charge attributable to shareholders' profit(ii) | **(25)** | (55) |
| Discontinued operations (net of tax) | **-** | (14) |
| Non-controlling interests | **(5)** | (1) |
| **Profit for the year attributable to equity holders of the Company** | **1,431** | 676 |

(i) The Company has amended the presentation of IFRS operating profit for its US insurance operations to remove the net equity hedge accounting effect (incorporating related amortisation of deferred acquisition costs) and include it in short-term fluctuations. 2009 amounts have been amended accordingly.
(ii) Tax charge attributable to shareholders' profit includes a credit of £158 million which primarily relates to the impact of a settlement agreed with the UK tax authorities.

The total profit before tax from continuing operations attributable to shareholders was £1,461 million in 2010, compared with £746 million in 2009. The improvement reflects the increase in operating profit based on longer-term investment returns and the impact of one-off items. The profit in 2010 was reduced by the terminated AIA transaction costs of £377 million, whereas 2009 was adversely impacted by the £621 million loss recorded as part of the disposal of the Taiwan Agency business and IGD hedge costs of £235 million.

In calculating the IFRS operating profit, we use longer-term investment return assumptions rather than actual investment returns arising in the year. The difference between actual investment returns recorded in the income statement and longer-term returns is shown in the analysis of profits as short-term fluctuations in investment returns.

*IFRS short-term fluctuations in investment returns*

Short-term fluctuations in investment returns for our insurance operations of negative £148 million comprise positive £114 million for Asia, negative £378 million for US operations and positive £116 million in the UK.

The positive short-term fluctuations of £114 million for our Asian operations primarily reflect unrealised gains on the shareholder debt portfolio, as well as a £30 million unrealised gain on the Group's 8.66 per cent stake in China Life Insurance Company of Taiwan.

The negative short-term fluctuations of £378 million for our US operations principally arise on derivative and embedded derivative value movements. They include the negative net equity hedge accounting effect (net of related DAC amortisation) of £367 million (2009: negative £159 million). The strong rise in the S&P Index in the last quarter of 2010 resulted in fair value reductions in the free-standing derivatives backing the guarantees embedded in Jackson's variable and fixed index annuity products. As a substantial proportion of these guarantees are not fair valued for accounting purposes, there is no accounting offset to these losses. Other US short-term fluctuations were negative £11 million.

The positive short-term fluctuations of £116 million for our UK operations reflect principally value movements on fixed income assets backing the capital of the shareholder-backed annuity business, brought about by the falls in yields during 2010.

Short-term fluctuations for other operations were positive £25 million and mainly represent unrealised appreciation on Prudential Capital's debt securities portfolio offset by unrealised value movements on centrally held derivatives. The 2009 result included £235 million costs incurred in respect of the hedge temporarily put in place during the first quarter to protect the IGD capital position in exceptional market conditions.

*Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes*

The shareholders' share of actuarial and other gains and losses on defined benefit pension schemes of negative £10 million reflects the impact of assumption changes, being primarily a lower discount rate applied to the liabilities of the Scottish Amicable and M&G schemes, partially offset by actual asset returns being higher than the long-term rate assumed.

*Costs of terminated AIA transaction*

During the period the Group incurred pre-tax costs in relation to the AIA transaction of £377 million. This comprises the termination break fee of £153 million, the costs associated with foreign exchange hedging of £100 million, underwriting fees of £58 million and advisor and other fees totalling £66 million. After expected tax relief, the post tax cost is £284 million.

*Gain on dilution of holding in PruHealth*

On 1st August 2010, Discovery Holdings of South Africa, the Group's joint venture partner in its investment in PruHealth, completed the acquisition of the entire share capital of Standard Life Healthcare, a wholly – owned subsidiary of the Standard Life Group, for £138 million. Discovery funded the purchase of the Standard Life Healthcare transaction, and contributed Standard Life Healthcare to PruHealth as a capital investment on completion. As a result of the transaction , Discovery have increased their shareholding in PruHealth from the previous level of 50 per cent to 75 per cent, and Prudential's shareholding reduced from 50 per cent of the previous joint venture structure to 25 per cent of the new structure of the much enlarged business.

As a result of this dilution in holding and the consequential loss of control, PruHealth has been reclassified from a joint venture to an associate and the entity is no longer proportionally consolidated from the date of the transaction. In accordance with IAS 31 'Interests in joint ventures' a gain of £30 million arises upon the dilution, representing the difference between the fair value of the enlarged 25 per cent investment still held and the IFRS book value of the original 50 per cent investment holding.

*Effective tax rates*

The effective rate of tax on operating profits, based on longer-term investment returns, was 11 per cent (2009: 24 per cent). Adjusting the reported tax rate to exclude the exceptional tax credit of £158 million which primarily relates to the impact of a settlement agreed with the UK tax authorities, the underlying tax rate on 2010 operating profits was 19 per cent. This is lower than 2009 primarily due to 2010 benefiting from revisions to prior period tax returns in the UK and an increase in the proportion of income in Asia which attracts lower tax. The effective rate of tax at the total IFRS profit level for continuing operations was two per cent (2009: seven per cent). Adjusting the rate in 2010 to exclude the exceptional tax credit of £158 million gives an underlying tax rate at the total IFRS profit level for 2010 of 13 per cent. In both 2009 and 2010, we have benefited from utilising carried forward tax losses for which no deferred tax asset had been previously recognised.

## EEV RESULTS

### EEV basis operating profit based on longer-term investment returns

| | AER | | | CER | |
|---|---|---|---|---|---|
| | **2010** | **2009** | **Change** | **2009** | **Change** |
| | **£m** | **£m** | **%** | **£m** | **%** |
| Insurance business | | | | | |
| Asia | **1,450** | 1,105 | 31 | 1,190 | 22 |
| US | **1,458** | 1,233 | 18 | 1,249 | 17 |
| UK | **936** | 870 | 8 | 870 | 8 |
| Development expenses | **(4)** | (6) | 33 | (6) | 33 |
| **Long-term business profit** | **3,840** | 3,202 | 20 | 3,303 | 16 |
| UK general insurance commission | **46** | 51 | (10) | 51 | (10) |
| Asset management business: | | | | | |
| M&G | **284** | 238 | 19 | 238 | 19 |
| Asia asset management | **72** | 55 | 31 | 58 | 24 |
| Curian | **1** | (6) | 117 | (6) | 117 |
| US broker dealer and asset management | **21** | 10 | 110 | 10 | 110 |
| | **4,264** | 3,550 | 20 | 3,654 | 17 |
| Other income and expenditure | **(494)** | (433) | 14 | (434) | 14 |
| Solvency II implementation costs | **(46)** | - | 100 | - | 100 |
| Restructuring costs | **(28)** | (27) | 4 | (27) | 4 |
| **Total EEV basis operating profit** | **3,696** | 3,090 | 20 | 3,193 | 16 |

In 2010, Prudential Group's total EEV basis operating profit based on longer-term investment returns was £3,696 million, an increase of 20 per cent from the same period in 2009.

Long-term business profits generated by the Group increased by 20 per cent to £3,840 million. These profits comprise:

- New business profits[1] of £2,028 million (2009: £1,619 million);
- In-force profits of £1,817 million (2009: £1,601 million); and
- Negative £5 million of other items including development expenses (2009: negative £18 million).

New business profits[1] at £2,028 million, were 25 per cent higher than last year, reflecting both a 23 per cent increase in sales volumes as compared to 2009. This represents a one percentage point increase in the average Group new business APE profit margin from 57 per cent in 2009 to 58 per cent in 2010.

Strong new business APE profit margins were recorded across the Group. The margin for the Asian business was maintained at 60 per cent and the UK new business margin increased by 13 percentage points to 45 per cent, benefiting both from the bulk annuity buy-in agreement written in December and higher underlying margins on retail business. The US maintained much of the high margins achieved in 2009, with margins falling by eight percentage points to 65 per cent, due primarily to anticipated reductions in spread margins on fixed and fixed index annuities and the impact of lower assumed equity return assumptions on variable annuities.

The contribution to operating profit from in-force business increased by £216 million to £1,817 million. This includes a £71 million increase in the unwind discount and other expected returns from £1,421 million in 2009 to £1,492 million in 2010, principally reflecting the growing maturity of the Asian in-force book. In-force profit in 2010 also includes the effect of operating assumption changes, experience variances and other items which had an aggregate positive impact of £325 million (2009: positive impact of £180 million). Of this amount, £328 million arises in the US primarily reflecting positive mortality, persistency, expense and spread experience variances. The most significant of these relates to spread experience, contributing £158 million in 2010, arising principally from transactions undertaken in the year to more closely match the overall asset and liability duration, the effect of which is expected to persist in 2011, but at a reduced level.

[1] Excluding Japan which ceased writing new business in 2010.

Overall the impact of operating assumption changes, experience variances and other items on Asia was negative £24 million, with adverse expense and persistency changes being offset by positive mortality and morbidity amounts.

In the UK operating assumption changes, experience variances and other items had an overall impact of positive £21 million, which is not significant in the context of the size of this business.

Operating profit from the asset management business and other non-long term businesses increased to £424 million, up 22 per cent from £348 million in 2009.

Other income and expenditure totalled a net expense of £494 million compared with £433 million in 2009. The £61 million increase, principally reflects the higher interest payable on core structural borrowings.

**EEV basis profit after tax and non-controlling interests**

| | AER 2010 £m | 2009 £m |
|---|---|---|
| EEV basis operating profit based on longer-term investment returns | **3,696** | 3,090 |
| Short-term fluctuations in investment returns: | | |
| - Insurance operations | **(55)** | 481 |
| - IGD hedge costs | **-** | (235) |
| - Other operations | **25** | 105 |
| | **(30)** | 351 |
| Mark to market value movements on core borrowings | **(164)** | (795) |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | **(11)** | (84) |
| Effect of changes in economic assumptions | **(10)** | (910) |
| Costs of terminated AIA transaction | **(377)** | - |
| Gain on dilution of holding in PruHealth | **3** | - |
| Profit on sale and results of Taiwan agency business | **-** | 91 |
| **Profit before tax from continuing operations** | **3,107** | 1,743 |
| Tax charge attributable to shareholders' profit (i) | **(530)** | (481) |
| Discontinued operations (net of tax) | **-** | (14) |
| Non-controlling interests | **(4)** | (3) |
| **Profit after non-controlling interests** | **2,573** | 1,245 |

(i) Tax charge attributable to shareholders' profit includes a credit of £158 million which primarily relates to the impact of a settlement agreed with the UK tax authorities.

*Short-term fluctuations in investment returns*

EEV operating profit is based on longer-term investment return assumptions rather than actual investment returns achieved. Short-term fluctuations represent the difference between the actual investment return and those assumed in arriving at the reported operating profit.

Short-term fluctuations in investment returns for insurance operations of negative £55 million comprise a positive £287 million for Asia, negative £678 million for our US operations and positive £336 million in the UK.

For our Asian business, short-term fluctuations of positive £287 million (2009: positive £437 million) primarily reflected the improvement in equity markets in 2010 and unrealised gains on the bond portfolio.

For our US business, short-term fluctuations in investment returns were negative £678 million (2009: negative £401 million), principally reflecting a reduction in expected yields on assets as a result of derisking activities within the portfolio and higher hedging costs, partially offset by separate account return in 2010 of 14.5 per cent being higher than the long-term expected level of 6.8 per cent.

For our UK business, the short-term fluctuations in investment returns were positive £336 million (2009: positive £445 million), principally due to the 2010 return on the investments of the with-profits life fund (covering policyholder liabilities and unallocated surplus) of positive 12.0 per cent being higher than the long-term assumed return of 6.7 per cent and to the unrealised gains arising on corporate bonds held as part of the annuity portfolio.

*Mark-to-market movement on core borrowings*

The mark-to-market movement on core borrowings was a negative £164 million, as credit spreads continued to narrow to more normal levels.

*Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes*

The shareholders' share of actuarial and other gains and losses on defined benefit pension schemes on the EEV basis comprises the IFRS charge attributable to shareholders, and the shareholders' share of movements in the scheme assets and liabilities attributable to the PAC with-profits fund. On the EEV basis there was a charge of negative £11 million (2009: negative £84 million) which mainly reflects the impact of assumption changes, being primarily a lower discount rate to the liabilities of the Scottish Amicable and M&G schemes partially offset by actual asset returns being higher than the long-term rate assumed.

*Effect of changes in economic assumptions*

The effect of changes in economic assumptions of negative £10 million comprises negative £71 million for Asia, negative £1 million for the US and positive £62 million for the UK.

In our Asian business, economic assumption changes were negative £71 million mainly reflecting the impact of falls in interest rates and the derisking of the portfolios in Hong Kong and Singapore.

In our US business, economic assumption changes were negative £1 million, with the fall in the separate account return being offset by the beneficial effect arising from the decrease in the risk discount rate following a reduction of 0.6 per cent in the US 10-year Treasury rate during the period.

In our UK business, economic assumption changes were positive £62 million, where the impact of the lower risk discount rate more than offset the effect of lower expected long-term rates of return following a reduction in UK Gilt rates of 0.4 per cent during 2010.

*Costs of terminated AIA transaction*

As previously discussed, the Group incurred pre-tax costs of £377 million in 2010 (£284 million post tax) related to the terminated AIA transaction.

*Gain on dilution of holding in PruHealth*

As previously discussed, the Company's holding of PruHealth has been reduced from 50 per cent to 25 per cent, following the injection into PruHealth of Standard Life Healthcare by the Group's joint venture partner, Discovery Holdings of South Africa.

On an EEV basis, a gain of £3 million arises upon the dilution, representing the difference between the fair value of the enlarged investment still held and the embedded value of the original 50 per cent investment holding. From 1st August the Group's incorporates 25 per cent of PruHealth's new business sales, profits and EEV in-force results into its consolidated EEV financial results.

*Effective tax rates*

The fall in the total tax rate, excluding the impact of the exceptional tax credit, from 28 per cent in 2009 to 22 per cent in 2010 arises from the effect of the mark to market value movements on core borrowings. As noted above, these movements gave rise to a charge in the EEV income statement of £164 million in 2010 and £795 million in 2009. As the liabilities are generally held to maturity or for the long-term, no deferred tax asset or liability is established on the market value adjustments and therefore, in 2010 and 2009 no deferred tax credits were established. The underlying tax rate on profits excluding the mark to market value adjustment on core borrowings and the exceptional tax credit was 21 per cent in 2010 as against 19 per cent in 2009.

## EARNINGS AND DIVIDEND PER SHARE

### Earnings per share

| | 2010 Excluding exceptional tax credit[i] pence | 2010 Including exceptional tax credit pence | 2009 pence |
|---|---|---|---|
| **Basic EPS based on operating profit after tax and non-controlling interests** | | | |
| IFRS [ii] | **62.0** | **68.3** | 47.5 |
| EEV | **106.9** | **113.2** | 88.8 |

(i) The exceptional tax credit in 2010 relates to a £158 million credit which primarily relates to the impact of a settlement agreed with the UK tax authorities.
(ii) The Company has amended the presentation of IFRS operating profit for its US insurance operations to remove the net equity hedge accounting effect (incorporating related amortisation of deferred acquisition costs) and include it in short-term fluctuations. 2009 amounts have been amended accordingly.

| | 2010 pence | 2009 pence |
|---|---|---|
| **Basic EPS based on total profit after non-controlling interests** | | |
| IFRS | **56.7** | 27.0 |
| EEV | **101.9** | 49.8 |

### Dividend per share

Interim dividends are recorded in the period in which they are paid. Final dividends are recorded in the period in which they are approved by shareholders. The second interim dividend of 13.56 pence per ordinary share for the year ended 31 December 2009 was paid to eligible shareholders on 27 May 2010 and the 2010 interim dividend of 6.61 pence per ordinary share was paid to eligible shareholders on 23 September 2010.

Following the Board's decision to rebase the dividend upwards and subject to shareholders' approval, the 2010 final dividend of 17.24 pence per ordinary share will be paid on 26 May 2011 in sterling to shareholders on the principal and Irish branch registers at 6.00 p.m BST on Friday, 1 April 2011 (the 'Record Date'), and in Hong Kong dollars to shareholders on the Hong Kong branch register at 4.30 p.m Hong Kong time on the Record Date ('HK Shareholders'). Holders of US American Depositary Receipts ('US Shareholders') will be paid their dividends in US dollars on or about five days after the payment date of the dividend to shareholders on the principal register. The final dividend will be paid on or about 2 June 2011 in Singapore dollars to shareholders with shares standing to the credit of their securities accounts with The Central Depository (Pte.) Limited ('CDP') at 5.00 p.m Singapore time on the Record Date ('SG Shareholders'). The dividend payable to the HK Shareholders will be translated using the exchange rate quoted by the WM Company at 4.00 p.m UK time on 8 March 2011. The exchange rate at which the dividend payable to the SG Shareholders will be translated into SG$ will be determined by CDP. The dividend will distribute an estimated £439 million of shareholders' funds.

The scrip dividend is not being offered in respect of this dividend. In its place shareholders will be offered a Dividend Reinvestment Plan (DRIP).

The final dividend of 17.24 pence per share brings the total dividend for the reporting period to 23.85 pence per share, 4 pence per share (20 per cent) higher than the 2009 total dividend.

The Board will maintain its focus on delivering a growing dividend from this new higher base, which will continue to be determined after taking into account the Group's financial flexibility and our assessment of opportunities to generate attractive returns by investing in specific areas of the business. The Board believes that in the medium term a dividend cover of around two times is appropriate.

**MOVEMENT ON SHAREHOLDERS' FUNDS**

| | IFRS | | EEV | |
|---|---|---|---|---|
| | 2010 | 2009 [e] AER | 2010 | 2009 AER |
| | £m | £m | £m | £m |
| Operating profit based on longer-term investment returns | **1,941** | 1,564 | **3,696** | 3,090 |
| Items excluded from operating profit | **(480)** | (818) | **(589)** | (1,347) |
| **Total profit before tax** | **1,461** | 746 | **3,107** | 1,743 |
| Exceptional tax credit | **158** | - | **158** | - |
| Tax, discontinued operations and non-controlling interests | **(188)** | (70) | **(692)** | (498) |
| **Profit for the period** | **1,431** | 676 | **2,573** | 1,245 |
| Exchange movements, net of related tax | **251** | (195) | **693** | (750) |
| Unrealised gains and losses on Jackson securities classified as available for sale[a] | **478** | 1,043 | **-** | - |
| Dividends | **(511)** | (481) | **(511)** | (481) |
| New share capital subscribed | **75** | 141 | **75** | 141 |
| Other | **36** | 29 | **104** | 162 |
| **Net increase in shareholders' funds** | **1,760** | 1,213 | **2,934** | 317 |
| Shareholders' funds at beginning of year | **6,271** | 5,058 | **15,273** | 14,956 |
| **Shareholders' funds at end of year** | **8,031** | 6,271 | **18,207** | 15,273 |
| Comprising | | | | |
| Long-term business | | | | |
| Free surplus [b] | | | **2,748** | 2,065 |
| Required capital | | | **3,415** | 2,994 |
| Net worth [c] | | | **6,163** | 5,059 |
| Value of in-force | | | **12,051** | 10,283 |
| Total | | | **18,214** | 15,342 |
| Other business [d] | | | **(7)** | (69) |
| **Total** [f] | | | **18,207** | 15,273 |

(a) Net of related changes to deferred acquisition costs and tax.
(b) The increase in free surplus of £683 million from 2010 arises primarily from £1,284 million being generated by the long-term business, off-set by cash paid to the holding company and other items.
(c) The increase in net worth in the period principally reflects the free surplus generated in the period, offset by cash paid to the holding company, changes to required capital and other items.
(d) Shareholders' funds for other than long-term business of negative £7 million (2009: negative £69 million) comprises £1,787 million for asset management operations (2009: £1,659 million), including goodwill of £1,230 million (2009: £1,230 million), holding company net borrowings of £2,212 million (2009: £1,780 million) and net other shareholders' funds of £418 million (2009: £52 million).
(e) The Company has amended the presentation of IFRS operating profit for its US insurance operations to remove the net equity hedge accounting credit effect (incorporating related amortisation of deferred acquisition costs) and include it in short-term fluctuations. 2009 amounts have been amended accordingly.
(f) EEV shareholders' funds excluding goodwill attributable to shareholders is £16,741 million (2009: £13,963 million).

*IFRS*

Statutory IFRS basis shareholders' funds at 31 December 2010 were £8.0 billion. This compares to the £6.3 billion at 31 December 2009, an increase of £1.7 billion, and equivalent to 28 per cent.

The movement reflects the profit for the year after tax and non-controlling interests of £1.4 billion, exchange translation gains of £0.3 billion, the improvement in the level of net unrealised gains on Jackson's debt securities of £0.5 billion from the position at 31 December 2009 and other items of £0.1 billion, offset by dividend payments of £0.5 billion.

*EEV*

On an EEV basis, which recognises the shareholders' interest in long-term business, shareholder funds at 31 December 2010 were £18.2 billion, an increase of £2.9 billion from the 2009 level, equivalent to 19 per cent. This increased level of shareholders' funds primarily reflects the profit after tax of £2.6 billion, the positive effects of exchange movements of £0.7 billion offset by the dividend payments of £0.5 billion.

The shareholders' funds at 31 December relating to long-term business of £18.2 billion comprise £7.4 billion (up 29 per cent from 2009) for our Asian long-term business operations, £4.8 billion (up 16 per cent from 2009) for our

US long-term business operations and £6.0 billion (up 10 per cent from 2009) for our UK long-term business operations.

At 31 December 2010, the embedded value for our Asian long-term business operations was £7.4 billion, with £6.0 billion (up 31 per cent from 2009) being in the South East Asia countries of Indonesia, Malaysia, Philippines, Singapore, Thailand, Vietnam together with Hong Kong. For Prudential's other Asian markets, the embedded value was £1.4 billion (up 21 per cent from 2009) in aggregate.

## FREE SURPLUS AND HOLDING COMPANY CASH FLOW

### Overview

The Group manages its internal cash flow by focusing on the free surplus generated by the life and asset management businesses as defined below and the percentage of net underlying free surplus that is remitted to the holding company as cash ('the remittance ratio'). The tables below set out the Group's free surplus generation for 2010, the holding company cash flow statement and a table showing the remittance ratio for each of the business operations.

### Free surplus generation

*Sources and uses of free surplus generation from the Group's insurance and asset management operations*

Group free surplus at the end of the period comprises free surplus for the insurance businesses, representing the excess of the net worth over the required capital included in the EEV results, and IFRS net assets for the asset management businesses excluding goodwill. The free surplus generated during the period comprises the movement in this balance excluding foreign exchange, capital movements, and other reserve movements. Specifically, it includes amounts maturing from the in-force operations during the period less the investment in new business, the effect of market movements and other one-off items.

For asset management operations we have defined free surplus generation to be total post-tax IFRS profit for the period. Group free surplus generated also includes the general insurance commission earned during the period and excludes shareholders' other income and expenditure, and centrally arising restructuring and Solvency II implementation costs.

The total movement in free surplus net of tax in the year can be analysed as follows:

| | **2010 £m** | **AER 2009 £m** |
|---|---|---|
| *Free surplus generation* | | |
| Expected in-force cash flows (including expected return on net assets) | **2,139** | 1,914 |
| Changes in operating assumptions and variances | **220** | 175 |
| **Underlying free surplus generated in the period from in-force business** | **2,359** | 2,089 |
| Market related items | **(94)** | (198) |
| Investment in new business: | | |
| Excluding Japan | **(643)** | (660) |
| Japan | **(2)** | (15) |
| Total investment in new business | **(645)** | (675) |
| **Free surplus generated in the period from retained businesses** | **1,620** | 1,216 |
| Effect of disposal and trading results of Taiwan agency business | **-** | 987 |
| Net cash remitted by the business units | **(935)** | (688) |
| Other movements and timing differences [(1)] | **122** | 157 |
| **Total movement during the period** | **807** | 1,672 |
| **Free surplus at 1 January** | **2,531** | 859 |
| **Free surplus at 31 December** | **3,338** | 2,531 |
| Comprised of: | | |
| Free surplus relating to long-term insurance business | **2,748** | 2,065 |
| Free surplus of other insurance business | **33** | 37 |
| IFRS net assets of asset management businesses excluding goodwill | **557** | 429 |
| Total free surplus | **3,338** | 2,531 |

[(1)] Included within other movements and timing differences is £18 million arising on the acquisition of UOB.

During 2010 we generated total free surplus from the retained businesses of £1,620 million (2009: £1,216 million). Underlying free surplus generated from the in-force book increased 13 per cent from £2,089 million in 2009 to £2,359 million in 2010, principally reflecting the underlying growth of the portfolio, and positive changes in operating assumptions and variances of positive £220 million for our life businesses (2009: positive £175 million). These positive changes include positive £3 million in Asia (2009: negative £98 million), £26 million arising in the UK (2009: positive £158 million), £191 million in the US principally reflecting favourable spread experience (2009: positive £115 million).

Underlying free surplus generated has been used by our life businesses to invest in new business. Investment in new business[1] has fallen by three per cent to £643 million in 2010. This compares to a 23 per cent increase in sales[1] and a 25 per cent increase in new business profits[1]. The strong improvement in capital efficiency is primarily the result of continuing the active management of the product and geographical mix of the new business sold, in line with the Group's disciplined approach to capital conservation and cash optimisation.

Market related movements have improved from negative £198 million in 2009 to negative £94 million in 2010, of which negative £192 million relates to the US principally reflecting investment returns on variable annuity business and related hedging activity. In addition, negative £74 million relates to the UK and is offset by positive £146 million relating to Asia principally related to favourable equity markets during 2010 and positive £26 million relating to our asset management businesses.

[1] Excludes Japan which ceased writing new business in 2010.

## Value created through investment in new business by life operations

| | 2010 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Asian operations | | | | | | |
| | Excluding Japan £m | Japan £m | Total £m | US operations £m | UK insurance operations £m | Group total excluding Japan £m | Group total including Japan £m |
| Free surplus invested in new business | (278) | (2) | (280) | (300) | (65) | **(643)** | **(645)** |
| Increase in required capital | 84 | - | 84 | 270 | 107 | **461** | **461** |
| Net worth invested in new business | (194) | (2) | (196) | (30) | 42 | **(182)** | **(184)** |
| Value of in-force created by new business | 866 | 1 | 867 | 525 | 224 | **1,615** | **1,616** |
| Post tax new business profit for the year | 672 | (1) | 671 | 495 | 266 | **1,433** | **1,432** |
| Tax | 230 | - | 230 | 266 | 99 | **595** | **595** |
| Pre-tax new business profit for the year | 902 | (1) | 901 | 761 | 365 | **2,028** | **2,027** |
| | | | | | | | |
| New business sales (APE) | 1,501 | | 1,508 | 1,164 | 820 | | |
| New business margins (% APE) | 60% | | 60% | 65% | 45% | | |
| Internal rate of return* | >20% | | >20% | >20% | >20% | | |

| | AER 2009 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Asian operations | | | | | | |
| | Excluding Japan £m | Japan £m | Total £m | US operations £m | UK insurance operations £m | Group total excluding Japan £m | Group total including Japan £m |
| Free surplus invested in new business | (231) | (15) | (246) | (326) | (103) | **(660)** | **(675)** |
| Increase in required capital | 69 | - | 69 | 300 | 82 | **451** | **451** |
| Net worth invested in new business | (162) | (15) | (177) | (26) | (21) | **(209)** | **(224)** |
| Value of in-force created by new business | 707 | 3 | 710 | 458 | 187 | **1,352** | **1,355** |
| Post tax new business profit for the year | 545 | (12) | 533 | 432 | 166 | **1,143** | **1,131** |
| Tax | 180 | - | 180 | 232 | 64 | **476** | **476** |
| Pre-tax new business profit for the year | 725 | (12) | 713 | 664 | 230 | **1,619** | **1,607** |
| | | | | | | | |
| New business sales (APE) | 1,209 | | 1,261 | 912 | 723 | | |
| New business margins (% APE) | 60% | | 57% | 73% | 32% | | |
| Internal rate of return* | >20% | | >20% | >20% | >15% | | |

| | CER 2009 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Asian operations | | | | | | |
| | Excluding Japan £m | Japan £m | Total £m | US operations £m | UK insurance operations £m | Group total excluding Japan £m | Group total including Japan £m |
| Free surplus invested in new business | (245) | (16) | (261) | (330) | (103) | **(678)** | **(694)** |
| Increase in required capital | 75 | - | 75 | 304 | 82 | **461** | **461** |
| Net worth invested in new business | (170) | (16) | (186) | (26) | (21) | **(217)** | **(233)** |
| Value of in-force created by new business | 759 | 3 | 762 | 464 | 187 | **1,410** | **1,413** |
| Post tax new business profit for the year | 589 | (13) | 576 | 438 | 166 | **1,193** | **1,180** |
| Tax | 194 | - | 194 | 235 | 64 | **493** | **493** |
| Pre-tax new business profit for the year | 783 | (13) | 770 | 673 | 230 | **1,686** | **1,673** |
| | | | | | | | |
| New business sales (APE) | 1,300 | | 1,356 | 924 | 723 | | |
| New business margins (% APE) | 60% | | 57% | 73% | 32% | | |
| Internal rate of return* | >20% | | >20% | >20% | >15% | | |

** The internal rate of return is equivalent to the discount rate at which the present value of the post-tax cash flows expected to be earned over the lifetime of the business written in shareholder-backed life funds is equal to the total invested capital to support the writing of the business. The capital included in the calculation of the IRR is equal to the amount required to pay acquisition costs and set up statutory reserves less premiums received, plus required capital. The impact of the time value of options and guarantees is included in the calculation.*

Overall, the Group wrote £3,485 million of sales on an APE basis[1] in 2010 (2009: £2,844 million) generating a post-tax new business contribution to embedded value of £1,433 million (2009: £1,143 million). To support these sales, we invested £643 million of capital (2009: £660 million). By focusing on sales of products and in geographies which are less capital intensive, the Group has increased the amount of post-tax new business profit contribution[1] to embedded value per £1 million of free surplus invested by 29 per cent to £2.2 million (2009: £1.7 million). We estimate the Group's internal rate of return for the 12 months ended 31 December 2010 to be greater than 20 per cent. The amount of capital invested covers both new business strain, including commissions, of £182 million (2009: £209 million) and the required capital of £461 million (2009: £451 million). Management will continue to focus on capital preservation and investment in those areas which add most value to the Group.

In Asia, investment in new business[1] was £278 million, which was up 20 per cent compared to 2009 (£231 million). This compares to a 24 per cent increase in new business sales (APE). For each £1 million of free surplus invested we generated £2.4 million of post-tax new business contribution to embedded value broadly consistent with 2009, excluding Japan (2009: £2.4 million)[1]. The average free surplus undiscounted payback period for business written in the 12 months to 31 December 2010 was three years (2009: three years).

In the US, investment in new business was £300 million, eight per cent lower than 2009 (£326 million) and considerably lower than the 28 per cent increase in APE new business sales. For each £1 million of free surplus invested we generated £1.7 million of post-tax new business contribution to embedded value (2009: £1.3 million). This higher return reflects a change in business mix with a higher proportion of variable annuity business and a reduced proportion of more capital intensive fixed annuities. The average free surplus undiscounted payback period for business written in the 12 months to 31 December 2010 was one year (2009: two years).

In the UK, investment in new business decreased by 37 per cent from £103 million in 2009 to £65 million in 2010. This decrease compares with a 13 per cent increase in APE new business sales in the period. For each £1 million of free surplus invested we generated £4.1 million of post-tax new business contribution to embedded value (2009: £1.6 million). This increase reflects the UK's disciplined approach to pricing which has led to higher retail margins across the product range in 2010. It is also improved by the large bulk annuity transaction undertaken in 2010, the size of which may not be repeated in future years. The average free surplus undiscounted payback period for shareholder-backed business written in the 12 months to 31 December 2010 was four years (2009: five years).

[1] Excludes Japan which ceased writing new business in 2010.

### Expected transfer of value of in-force (VIF) and required capital business to free surplus

The preceding tables focused on actual free surplus in the year from the in-force book of business and the level of investment in new business. The tables below show how the VIF generated by the in-force long-term business and the associated required capital is modelled as emerging into free surplus over future years. The modelled cash flows use the same methodology underpinning the Group's embedded value reporting and so are subject to the same assumptions and sensitivities.

In addition to showing the amounts, both discounted and undiscounted, expected to be generated from all in-force business at 31 December 2010, the tables also present the expected future free surplus to be generated from the investment made in new business during 2010.

| | 2010 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Undiscounted expected generation from all in-force business at 31 December* | | | | Undiscounted expected generation from 2010 long-term new business written* | | | |
| Expected period of emergence | Asia £m | US £m | UK £m | Total £m | Asia £m | US £m | UK £m | Total £m |
| 2011 | 635 | 852 | 436 | **1,923** | 93 | 313 | 21 | **427** |
| 2012 | 598 | 546 | 407 | **1,551** | 106 | 134 | 28 | **268** |
| 2013 | 573 | 490 | 516 | **1,579** | 132 | 85 | 27 | **244** |
| 2014 | 558 | 440 | 451 | **1,449** | 99 | (18) | 24 | **105** |
| 2015 | 554 | 449 | 443 | **1,446** | 91 | 97 | 26 | **214** |
| 2016 | 554 | 380 | 433 | **1,367** | 78 | 72 | 28 | **178** |
| 2017 | 541 | 371 | 432 | **1,344** | 79 | 56 | 26 | **161** |
| 2018 | 521 | 349 | 428 | **1,298** | 80 | 89 | 25 | **194** |
| 2019 | 495 | 288 | 424 | **1,207** | 79 | 73 | 26 | **178** |
| 2020 | 478 | 274 | 416 | **1,168** | 74 | 63 | 37 | **174** |
| 2021 | 468 | 255 | 409 | **1,132** | 73 | 59 | 24 | **156** |
| 2022 | 461 | 216 | 405 | **1,082** | 68 | 49 | 24 | **141** |
| 2023 | 446 | 178 | 406 | **1,030** | 69 | 38 | 25 | **132** |
| 2024 | 439 | 162 | 401 | **1,002** | 67 | 32 | 24 | **123** |
| 2025 | 429 | 138 | 393 | **960** | 65 | 27 | 24 | **116** |
| 2026 | 438 | 123 | 383 | **944** | 62 | 23 | 24 | **109** |
| 2027 | 433 | 113 | 375 | **921** | 64 | 19 | 24 | **107** |
| 2028 | 425 | 106 | 368 | **899** | 61 | 17 | 25 | **103** |
| 2029 | 422 | 88 | 361 | **871** | 64 | 14 | 24 | **102** |
| 2030 | 416 | 84 | 350 | **850** | 57 | 9 | 26 | **92** |
| 2031-2035 | 2,040 | 303 | 1,445 | **3,788** | 303 | 27 | 115 | **445** |
| 2036-2040 | 1,992 | 171 | 1,040 | **3,203** | 271 | 4 | 118 | **393** |
| 2041-2045 | 2,007 | - | 510 | **2,517** | 269 | - | 75 | **344** |
| 2046-2050 | 2,021 | - | 301 | **2,322** | 279 | - | 50 | **329** |
| 2050+ | 10,453 | - | 344 | **10,797** | 1,997 | - | 41 | **2,038** |
| Total | 28,397 | 6,376 | 11,877 | **46,650** | 4,680 | 1,282 | 911 | **6,873** |

**The analysis excludes amounts incorporated into VIF at 31 December 2010 where there is no definitive timeframe for when the payments will be made. In particular it excludes the value of the shareholders' interest in the estate. All amounts have been translated at year end exchange rates.*

The above amounts can be reconciled to the new 2010 business amounts as follows:

| 2010 New business | Asia + £m | US £m | UK £m | Total £m |
|---|---|---|---|---|
| Undiscounted expected free surplus generation | 4,680 | 1,282 | 911 | 6,873 |
| Less: discount effect | (3,713) | (434) | (582) | (4,729) |
| Discounted expected free surplus generation | 967 | 848 | 329 | 2,144 |
| Less: Free surplus investment in new business | (280) | (300) | (65) | (645) |
| Other items** | (16) | (53) | 2 | (67) |
| Post tax EEV new business profit | 671 | 495 | 266 | 1,432 |
| Tax | 230 | 266 | 99 | 595 |
| **Pre tax EEV new business profit** | 901 | 761 | 365 | 2,027 |

** Other items represents the impact of the time value of options and guarantees on new business, foreign exchange effects and other non-modelled items. Foreign exchange effects arise as EEV new business profit amounts are translated at average exchange rates and expected free surplus generation uses year end closing rates.

+ Includes Japan.

The equivalent discounted amounts of the totals shown in the table on the preceding are outlined below:

| | 2010 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Discounted expected generation from all in-force business at 31 December | | | | Discounted expected generation from long-term 2010 new business written | | | |
| | **Asia** | **US** | **UK** | **Total** | **Asia** | **US** | **UK** | **Total** |
| Expected period of emergence | **£m** | **£m** | **£m** | **£m** | **£m** | **£m** | **£m** | **£m** |
| 2011 | 575 | 800 | 403 | **1,778** | 88 | 292 | 18 | **398** |
| 2012 | 510 | 481 | 348 | **1,339** | 91 | 116 | 24 | **231** |
| 2013 | 444 | 408 | 405 | **1,257** | 101 | 68 | 22 | **191** |
| 2014 | 405 | 344 | 333 | **1,082** | 70 | (13) | 18 | **75** |
| 2015 | 370 | 325 | 303 | **998** | 59 | 68 | 19 | **146** |
| 2016 | 343 | 258 | 274 | **875** | 47 | 48 | 19 | **114** |
| 2017 | 310 | 237 | 255 | **802** | 44 | 35 | 16 | **95** |
| 2018 | 280 | 207 | 234 | **721** | 41 | 50 | 15 | **106** |
| 2019 | 249 | 161 | 215 | **625** | 38 | 39 | 14 | **91** |
| 2020 | 225 | 144 | 195 | **564** | 33 | 31 | 19 | **83** |
| 2021 | 207 | 125 | 177 | **509** | 30 | 27 | 12 | **69** |
| 2022 | 190 | 99 | 163 | **452** | 27 | 21 | 11 | **59** |
| 2023 | 170 | 78 | 151 | **399** | 25 | 15 | 11 | **51** |
| 2024 | 157 | 66 | 138 | **361** | 22 | 11 | 9 | **42** |
| 2025 | 142 | 53 | 126 | **321** | 19 | 9 | 9 | **37** |
| 2026 | 139 | 45 | 113 | **297** | 19 | 7 | 8 | **34** |
| 2027 | 128 | 40 | 102 | **270** | 18 | 6 | 8 | **32** |
| 2028 | 117 | 35 | 93 | **245** | 16 | 5 | 7 | **28** |
| 2029 | 108 | 28 | 84 | **220** | 15 | 4 | 7 | **26** |
| 2030 | 99 | 25 | 76 | **200** | 12 | 2 | 7 | **21** |
| 2031-2035 | 400 | 79 | 240 | **719** | 53 | 5 | 25 | **83** |
| 2036-2040 | 275 | 40 | 109 | **424** | 35 | 2 | 18 | **55** |
| 2041-2045 | 195 | - | 29 | **224** | 24 | - | 8 | **32** |
| 2046-2050 | 139 | - | 11 | **150** | 18 | - | 4 | **22** |
| 2050+ | 152 | - | 6 | **158** | 22 | - | 1 | **23** |
| **Total** | 6,329 | 4,078 | 4,583 | **14,990** | 967 | 848 | 329 | **2,144** |

The above amounts can be reconciled to the Group's financial statements as follows:

| | **Total** |
|---|---|
| | **£m** |
| Discounted expected generation from all in-force business at 31 December 2010 | 14,990 |
| Add: Free surplus of life operations held at 31 December 2010 | 2,748 |
| Less: Time value of options and guarantees | (369) |
| Other non-modelled items* | 845 |
| Total EEV of life operations | 18,214 |

**These relate to items where there is no definitive timeframe for when the payments will be made and are, consequently, excluded from the amounts incorporated into the tables above showing the expected generation of free surplus from in-force business at 31 December 2010. In particular it excludes the value of the shareholders' interest in the estate.*

In recent years, our strategic focus on capital conservation and value optimisation has enabled us to transform the free surplus generation profile of the Group. The undiscounted in-force free surplus generation ability of the Group is now significant, with all businesses contributing material amounts.

Our disciplined approach to writing low strain, high return, short payback new business, produces an expected free surplus generation profile with sizeable free surplus releases in the early years, thereby ensuring that the initial investment is paid-back quickly and incremental profits are earned thereafter.

The combination of the long-term business in-force releases depicted in the above tables, coupled with asset management profits, returns on excess assets together with the impact of future new business, re-enforces our confidence that we remain on track to deliver a cumulative net free surplus after new business investment of £6.5 billion in the 2010 to 2013 period.

**Holding company cash flow**

We continue to manage cash flows across the Group with a view to achieving a balance between ensuring sufficient net remittances from the businesses to cover the progressive dividend (after corporate costs) and maximising value for shareholders through the retention and the reinvestment of the free surplus generated at business unit level in the particularly profitable opportunities available to the Group given its established position in key life insurance markets. On this basis, the holding company cash flow statement at an operating level should ordinarily balance close to zero before exceptional cash flows, but from time to time additional remittances from business operations will be made to provide the Group with greater financial flexibility at the corporate centre.

| | 2010 £m | 2009 £m |
|---|---|---|
| **Net cash remitted by business units:** | | |
| UK Life fund paid to Group | **202** | 284 |
| Shareholder-backed business: | | |
| Other UK paid to Group | **275** | 189 |
| Group invested in UK | **(57)** | (39) |
| Total shareholder-backed business | **218** | 150 |
| **UK net** | **420** | 434 |
| US paid to Group | **80** | 39 |
| Group invested in US | **-** | - |
| **US net** | **80** | 39 |
| Asia paid to Group | | |
| Long-term business | **330** | 181 |
| Other operations | **33** | 46 |
| | **363** | 227 |
| Group invested in Asia | | |
| Long-term business | **(63)** | (101) |
| Other operations | **(67)** | (86) |
| | **(130)** | (187) |
| **Asia net** | **233** | 40 |
| **M&G paid to Group** | **150** | 93 |
| **PruCap paid to Group** | **52** | 82 |
| **Net remittances to Group from Business Units** | **935** | 688 |
| Net interest paid | **(231)** | (214) |
| Tax received | **185** | 71 |
| Corporate activities | **(146)** | (163) |
| Solvency II costs | **(34)** | - |
| **Total central outflows** | **(226)** | (306) |
| **Operating holding company* cash flow before dividend** | **709** | 382 |
| Dividend paid net of scrip | **(449)** | (344) |
| **Operating holding company* cash flow after dividend** | **260** | 38 |
| Exceptional Items: | | |
| Cash flow arising from sale of Taiwan agency business | **-** | (125) |
| Acquisition of UOB Life and related distribution agreements | **(276)** | - |
| Costs of terminated AIA transaction | **(377)** | - |
| IGD hedge costs | **-** | (235) |
| Bank loan reorganisation | **120** | - |
| Other cash movements: | | |
| Issue of hybrid debt, net of costs | **-** | 822 |
| Repayment of maturing debt | **-** | (249) |
| Receipts arising from foreign exchange movements on US$ hedging instruments | **-** | 60 |
| Total holding company cash flow | **(273)** | 311 |
| Cash and short term investments at beginning of period | **1,486** | 1,165 |
| Foreign exchange movements | **19** | 10 |
| **Cash and short term investments at end of period** | **1,232** | 1,486 |

* Including central finance subsidiaries.

Operating holding company cash flow for 2010 before the shareholder dividend was £709 million, £327 million higher than 2009. After deducting the shareholder dividend paid net of scrip, the operating holding company cash flow was positive £260 million (2009: £38 million).

## Cash remittances as a percentage of free surplus

As previously highlighted, the Group focuses on the generation of free surplus by each of the Group's business units and then balances cash remittances from these units between financing new business growth, managing market shocks and covering the Group's central outgoings, including the shareholder dividend. The following table highlights this balance by comparing the 2010 net underlying free surplus generated with the net amounts that have been remitted by each of our underlying business operations.

### Remittance ratio analysis

| | 2010 | | | 2009 | | |
|---|---|---|---|---|---|---|
| | **Net remittance to Group** | **Net underlying free surplus (i)** | **Remittance ratio** | **Net Remittance to Group** | **Net underlying free surplus (i)** | **Remittance ratio** |
| | **£m** | **£m** | **%** | £m | £m | % |
| Asia | **233** | **383** | **61** | 40 | 161 | 25 |
| US | **80** | **627** | **13** | 39 | 516 | 8 |
| UK | **420** | **497** | **85** | 434 | 562 | 77 |
| M&G (including PruCap) | **202** | **207** | **98** | 175 | 175 | 100 |
| Total | **935** | **1,714** | **55** | 688 | 1,414 | 49 |

(i) Underlying free surplus generated in the period from in-force business less investment in new business.

The holding company received £935 million of net cash remittances from the business units in 2010, an increase of £247 million from 2009. Overall net remittances as a percentage of net underlying free surplus increased from 49 per cent in 2009 to 55 per cent in 2010. In line with the Group's strategy the highest remittance ratios are from the UK businesses. The UK insurance operations remitted £420 million in 2010 (2009: £434 million), equivalent to 85 per cent of net underlying free surplus. Contributions from UK with-profits were lower reflecting the bonus reductions effected at the start of 2009, resulting in a lower share for shareholders in that year and lower remittances in 2010. Net remittances from our shareholder-backed businesses were £218 million, an increase of £68 million from 2009. M&G and PruCap collectively remitted £202 million in 2010 (2009: £175 million) equivalent to 98 per cent of net underlying free surplus.

Asia remitted net cash of £233 million in 2010, an increase of £193 million from the net £40 million remitted in 2009. This includes a one-off remittance of £130 million from Malaysia, representing the accumulation of historic distributable reserves. Total injections in 2010 were £130 million; £57 million lower than the £187 million paid in 2009. This primarily reflects the injection made into Taiwan in 2009 to facilitate the required restructuring after the sale of the agency business in that year.

Cash received from Jackson was £80 million in 2010, £41 million higher than the £39 million remitted in 2009. This is equivalent to a modest proportion of net underlying free surplus generated, reflecting our decision to retain free surplus in the business, in order to provide the capital to capture the attractive new business returns created by the market dislocation and to rebuild the capital buffers of this business following the 2008/2009 financial crisis. From 2011, it is planned that Jackson will increase the level of remittances to the Group.

Central outflows improved by £80 million to £226 million in 2010 (2009: £306 million). Lower corporate costs and higher tax receipts in 2010 more than offset increased net interest payments, following the additional debt raised in 2009, and Solvency II project spend.

Following a settlement reached with the UK tax authorities in relation to matters arising principally in 2001 to 2008, £266 million in exceptional tax outflows are expected to be made over the period from 2011 to 2013. We anticipate that half will be paid in 2011 and the remainder split evenly over 2012 and 2013.

After central costs, there was a net cash inflow before dividend of £709 million in 2010 compared to £382 million for 2009. The dividend paid net of scrip, was £449 million in 2010 compared to £344 million in 2009. The take-up of scrip dividends in 2010 was £62 million compared to £137 million for 2009.

In 2010, central cash resources funded the acquisition of UOB Life and related distribution agreements. In addition, £377 million relating to costs associated with the terminated AIA transaction were also funded from our central resources. Offsetting these outflows were net funds received of £120 million following bank loan reorganisation.

As a result of the transactions above, together with a £19 million foreign exchange revaluation gain, the overall holding company cash and short-term investment balances at 31 December 2010 decreased by £254 million to £1.2 billion from the £1.5 billion at 31 December 2009.

## BALANCE SHEET

### Summary

| | AER 2010 £m | 2009 £m |
|---|---|---|
| Goodwill attributable to shareholders | **1,466** | 1,310 |
| Investments | **239,297** | 208,722 |
| Holding company cash and short-term investments | **1,232** | 1,486 |
| Other | **18,811** | 16,236 |
| Total assets | **260,806** | 227,754 |
| Less: Liabilities | | |
| Policyholder liabilities | **214,727** | 186,398 |
| Unallocated surplus of with-profits funds | **10,253** | 10,019 |
| | **224,980** | 196,417 |
| Less: Shareholders' accrued interest in the long-term business | **(10,176)** | (9,002) |
| | **214,804** | 187,415 |
| Core structural borrowings of shareholders' financed operations (IFRS book value basis) | **3,676** | 3,394 |
| Other liabilities including non-controlling interest | **24,119** | 21,672 |
| Total liabilities and non-controlling interest | **242,599** | 212,481 |
| **EEV basis net assets** | **18,207** | 15,273 |
| | | |
| Share capital and premium | **1,983** | 1,970 |
| IFRS basis shareholders' reserves | **6,048** | 4,301 |
| IFRS basis shareholders' equity | **8,031** | 6,271 |
| Additional EEV basis retained profit | **10,176** | 9,002 |
| **EEV basis shareholders' equity (excluding non-controlling interest)** | **18,207** | 15,273 |

The following sections focus on key areas of interest in the balance sheet.

*Investments*

| | 2010 | | | | 2009 |
|---|---|---|---|---|---|
| | **Participating funds £m** | **Unit-linked and variable annuities £m** | **Shareholder-backed £m** | **Total Group £m** | **Total Group** £m |
| Debt securities | 53,261 | 9,054 | 54,037 | 116,352 | 101,751 |
| Equity | 31,371 | 54,274 | 990 | 86,635 | 69,354 |
| Property investments | 8,993 | 745 | 1,509 | 11,247 | 10,905 |
| Commercial mortgage loans | 256 | - | 4,693 | 4,949 | 4,634 |
| Other loans | 1,888 | - | 2,424 | 4,312 | 4,120 |
| Deposits | 7,272 | 749 | 1,931 | 9,952 | 12,820 |
| Other investments[a] | 3,887 | 131 | 1,832 | 5,850 | 5,138 |
| Total | 106,928 | 64,953 | 67,416 | 239,297 | 208,722 |

[a] Including £71 million of investments, including PruHealth from 1 August 2010, accounted for using the equity method (2009: £6 million).

Total investments held by the Group at 31 December 2010 were £239 billion, of which £107 billion were held by participating funds, £65 billion by unit-linked funds and £67 billion by shareholder-backed operations. Shareholders are not directly exposed to value movements on assets backing participating or unit-linked operations, with sensitivity mainly related to shareholder-backed operations.

Of the £ 67 billion investments related to shareholder-backed operations, £6 billion was held by Asia long-term business, £32 billion by Jackson and £26 billion by the UK long-term business respectively. In addition £3 billion is held by our asset management and other operations.

The investments held by the shareholder-backed operations are predominantly debt securities, totalling £54 billion, £4 billion, £26 billion and £22 billion for Asia, the US and the UK long-term businesses respectively, of which 84 per cent, 95 per cent and 98 per cent are rated, either externally or internally, as investment grade.

In addition £2 billion of debt securities was held by asset management and other operations, substantially all of which was managed by Prudential Capital.

*Policyholder liabilities and unallocated surplus of with-profits funds*

| | 2010 | | | | AER 2009 |
|---|---|---|---|---|---|
| | **Asia** | **US** | **UK** | **Total** | **Total** |
| | **£m** | **£m** | **£m** | **£m** | **£m** |
| **Shareholder-backed business** | | | | | |
| At 1 January | 13,050 | 48,311 | 38,700 | **100,061** | 92,189 |
| Premiums | 3,270 | 11,735 | 4,579 | **19,584** | 15,757 |
| Surrenders | (1,800) | (3,598) | (1,326) | **(6,724)** | (5,672) |
| Maturities/Deaths | (172) | (769) | (2,224) | **(3,165)** | (2,914) |
| **Net flows** | **1,298** | **7,368** | **1,029** | **9,695** | 7,171 |
| Investment related items and other movements | 1,523 | 3,464 | 4,289 | **9,276** | 10,820 |
| Assumption changes | 19 | - | (46) | **(27)** | (113) |
| Acquisition of UOB Life Assurance Limited | 464 | - | - | **464** | - |
| Dilution of holding in PruHealth | - | - | (27) | **(27)** | |
| Disposal of Taiwan agency business | - | - | - | **-** | (3,508) |
| Foreign exchange translation difference | 1,362 | 1,380 | (1) | **2,741** | (6,498) |
| At 31 December | 17,716 | 60,523 | 43,944 | **122,183** | 100,061 |
| **With-profits funds** | | | | | |
| - Policyholder liabilities | | | | **92,544** | 86,337 |
| - Unallocated surplus | | | | **10,253** | 10,019 |
| **Total at 31 December** | | | | **102,797** | 96,356 |
| **Total policyholder liabilities including unallocated surplus at 31 December** | | | | **224,980** | 196,417 |

Policyholder liabilities related to shareholder-backed business grew by £22.1 billion from £100.1 billion at 31 December 2009 to £122.2 billion at 31 December 2010.

The increase reflects positive net flows (premiums less surrenders and maturities/deaths) of £9.7 billion in 2010 (2009: £7.2 billion), driven by strong inflows in the US (£7.4 billion) and Asia (£1.3 billion) and the £0.9 billion bulk annuity transaction in the UK. Positive investment-related and other items of £9.3 billion (2009: £10.8 billion) also contributed to the growth following improvements in the bond and equity markets during the year.

Other movements include foreign exchange movements of positive £2.7 billion (2009: negative £6.5 billion) and an increase following the acquisition of UOB Life of £464 million.

During 2010, the unallocated surplus, which represents the excess of assets over policyholder liabilities for the Group's with-profit funds on a statutory basis, increased two per cent in 2010 to £10.3 billion.

*Fair valuation of guarantees attaching to Jackson's variable annuity business*

The IFRS accounting for guarantees on US variable annuity contracts has a mixed measurement approach. GMWB 'not for life' contract features are fair valued under IAS 39 and FAS 157 with a capping feature to prevent early anticipation of expected fees for guarantees. However, the GMDB and GMWB 'for life' blocks of business are accounted for under grandfathered US GAAP which does not, and is not intended to, fair value the liabilities.

If we had fair valued the GMDB and GMWB 'for life' guarantees as if they were embedded derivatives but restricted or capped the recognition of future fees in line with IFRS, the liabilities at 31 December 2010 would have been higher by some £650 million and £50 million, respectively. After offsetting related adjustments to DAC amortisation and deferred tax, the net effect would have been a reduction in shareholders' equity of approximately £150 million.

If the liabilities were re-measured to fair value them using IAS 39 and FAS 157 principles, but with the removal of the fee capping feature, so as to include the full value of future expected fees for guarantees, the change in liability from the IFRS accounting value would be favourable by some £100 million. After offsetting related adjustments to DAC amortisation on the respective GMDB and GMWB components of the change, and for deferred tax, the net effect would be an increase in shareholders' equity, which is also estimated to be approximately £100 million.

*Shareholders' net borrowings and ratings*

Shareholders' net borrowings at 31 December 2010:

| | AER | | | | | |
|---|---|---|---|---|---|---|
| | 2010 | | | 2009 | | |
| | IFRS basis | Mark to market value | EEV basis | IFRS basis | Mark to market value | EEV basis |
| | £m | £m | £m | £m | £m | £m |
| Perpetual subordinated | | | | | | |
| Capital securities (Innovative Tier 1) | **1,463** | **28** | **1,491** | 1,422 | (71) | 1,351 |
| Subordinated notes (Lower Tier 2) | **1,255** | **117** | **1,372** | 1,269 | 103 | 1,372 |
| | **2,718** | **145** | **2,863** | 2,691 | 32 | 2,723 |
| Senior debt | | | | | | |
| 2023 | **300** | **33** | **333** | 300 | 8 | 308 |
| 2029 | **249** | **(1)** | **248** | 249 | (14) | 235 |
| Holding company total | **3,267** | **177** | **3,444** | 3,240 | 26 | 3,266 |
| Prudential Capital | **250** | **-** | **250** | - | - | - |
| Jackson surplus notes (Lower Tier 2) | **159** | **13** | **172** | 154 | 4 | 158 |
| Total | **3,676** | **190** | **3,866** | 3,394 | 30 | 3,424 |
| Less: Holding company cash and short-term investments | **(1,232)** | **-** | **(1,232)** | (1,486) | - | (1,486) |
| Net core structural borrowings of shareholder-financed operations | **2,444** | **190** | **2,634** | 1,908 | 30 | 1,938 |

The Group's core structural borrowings at 31 December 2010 totalled £3.7 billion on an IFRS basis, compared with £3.4 billion at 31 December 2009. The movement of £0.3 billion mainly reflects the addition of a £250 million bank funding facility in the period following activities to reorganise certain bank loans in the period.

After adjusting for holding company cash and short-term investments of £1.2 billion, net core structural borrowings at 31 December 2010 were £2.4 billion compared with £1.9 billion at 31 December 2009. The movement of £0.5 billion includes positive operating cash flows of £0.3 billion, the movement in borrowings of £0.3 billion mentioned above and the use of £0.7 billion of central resources to fund the acquisition of UOB Life and related distribution agreements and the terminated AIA transaction costs.

In January 2011, the Company issued US $550 million 7.75 per cent Tier 1 subordinated debt, primarily to retail investors. The proceeds, net of costs, were US $539 million and are intended to finance the repayment of the €500 million Tier 2 subordinated notes in December 2011.

The Group operates a central treasury function, which has overall responsibility for managing our capital funding programme as well as our central cash and liquidity positions.

In addition to our core structural borrowings set out above, we also have in place an unlimited global commercial paper programme. As at 31 December 2010, we had issued commercial paper under this programme totalling £127 million, US$2,350 million, EUR 743 million and CHF 50 million. The central treasury function also manages our £5,000 million medium-term note (MTN) programme, covering both core and non-core borrowings. During January 2010, we raised non-core borrowings of £250 million from this programme. In April and October 2010 we refinanced an existing internal £200 million issue under the same programme. In total, at 31 December 2010 the outstanding subordinated debt under the programme was £835 million, US$750 million and EUR 520 million, while the senior debt outstanding was £450 million. In addition, our holding company has access to £2.1 billion of syndicated and bilateral committed revolving credit facilities, provided by 17 major international banks, expiring between 2011 and 2015. Apart from small drawdowns to test the process, these facilities have never been drawn, and there were no amounts outstanding at 31 December 2010. The commercial paper programme, the MTN programme and the committed revolving credit facilities are all available for general corporate purposes and to support the liquidity needs of our holding company and are intended to maintain a strong and flexible funding capacity.

We manage the Group's core debt within a target level consistent with our current debt ratings. At 31 December 2010, the gearing ratio (debt, net of cash and short-term investments, as a proportion of EEV shareholders' funds plus debt) was 11.8 per cent, compared with 11.1 per cent at 31 December 2009. Prudential plc has strong debt

ratings from Standard & Poor's, Moody's and Fitch. Prudential's long-term senior debt is rated A+, A2 (negative outlook) and A from Standard & Poor's, Moody's and Fitch, while short-term ratings are A-1, P-1 and F1 respectively.
The financial strength of PAC is rated AA by Standard & Poor's, Aa2 (negative outlook) by Moody's and AA by Fitch.

Jackson National Life's financial strength is rated AA by Standard & Poor's, A1 (negative outlook) by Moody's and AA by Fitch.

*Financial position on defined benefit pension schemes*

The Group currently operates three defined benefit schemes in the UK, of which by far the largest is the Prudential Staff Pension Scheme (PSPS) and two smaller schemes, Scottish Amicable (SAPS) and M&G.

Defined benefit schemes in the UK are generally required to be subject to a full actuarial valuation every three years, in order to assess the appropriate level of funding for schemes in relation to their commitments. The valuations of PSPS as at 5 April 2008 and SAPS as at 31 March 2008 were finalised in the second quarter of 2009. The valuation of the M&G pension scheme as at 31 December 2008 was finalised in January 2010. The valuation of PSPS demonstrated the scheme to be 106 per cent funded by reference to the Scheme Solvency Target that forms the basis of the scheme's funding objective. No formal deficit plan was required. However, in recognition of the fall in value of the Scheme's investments between 5 April 2008 and the completion of the actuarial valuation, additional funding akin to deficit funding was agreed by the Trustees. This is subject to reassessment when the next valuation is completed. The total contributions being currently made by the Group into the scheme, representing the annual accrual cost and deficit funding, are £50 million per annum. Deficit funding for PSPS is apportioned in the ratio of 70/30 between the PAC with-profits fund and shareholder-backed operations.

The actuarial valuation of SAPS as at 31 March 2008 demonstrated the scheme to be 91 per cent funded, representing a deficit of £38 million. Based on this valuation and subsequent agreements with the Trustees, £13.1 million per annum of deficit funding is currently being paid into the scheme. The next triennial valuations for the PSPS and SAPS schemes are scheduled to take place as at 5 April 2011 and 31 March 2011 respectively.

The actuarial valuation of the M&G pension scheme as at 31 December 2008 demonstrated the scheme to be 76 per cent funded, representing a deficit of £51 million. Based on this valuation, deficit funding amounts designed to eliminate the actuarial deficit over a five year period have been agreed with £14.1 million being paid in each of 2010 and 2011 and £9.3 million per annum for the subsequent three years.

The valuation basis under IAS 19 for the Group financial statements differs markedly from the full triennial actuarial valuation basis. In particular, reflecting the trust deed provisions over distributions, the net underlying surplus of £421 million for PSPS is not recognised. As at 31 December 2010, on the Group IFRS statement of financial position, the shareholders' share of the liabilities for these UK schemes amounted to a £83 million liability net of related tax relief. The total share attributable to the PAC with-profits fund amounted to a liability of £99 million net of related tax relief.

*Changes to Group holdings during the period*

During 2010 we completed the acquisition of UOB Life for total cash consideration, of SGD 495 million (£220 million), giving rise to goodwill of £141 million. This acquisition accompanied a long-term strategic partnership with UOB facilitating distribution of Prudential's life insurance products through UOB's bank branches in Singapore, Indonesia and Thailand.

We also announced the acquisition of Standard Life Healthcare by our PruHealth joint venture partner Discovery and its combination with the existing PruHealth business. This led to a reduction in our shareholding in the enlarged combined businesses from 50 per cent to 25 per cent effective from 1 August, the date of the acquisition. The effects on our EEV and IFRS accounting are as previously set out in this review.

*Financial instruments*

The Group is exposed to financial risk through its financial assets, financial liabilities, and policyholder liabilities. The key financial risk factors that affect the Group include market risk, credit risk and liquidity risk. Information on the Group's exposure to financial risk factors, and our financial risk management objectives and policies, is provided both in our Risk and Capital Management section of the Business Review and the financial statements. Further information on the sensitivity of the Group's financial instruments to market risk and its use of derivatives is also provided in the financial statements.

## RISK AND CAPITAL MANAGEMENT

As a provider of financial services, including insurance, the management of risk lies at the heart of our business. As a result, effective risk management capabilities represent a key source of competitive advantage for our Group.

The Group's risk appetite framework sets out our appetite for risk exposures as well as our approach to risk management and return optimisation. Under this approach, we monitor our risk profile continuously against agreed limits. Our main strategies for managing and mitigating risk include asset liability management, using derivatives to hedge relevant market risks, and implementing reinsurance and corporate insurance programmes.

### Risk oversight

#### *Group risk appetite*

We define and monitor aggregate risk limits for our earnings volatility and our capital requirements based on financial and non-financial stresses:

(a) *Earnings volatility*: the objectives of the limits are to ensure that (a) the volatility of our earnings is consistent with our stakeholders' expectations, (b) the Group has adequate earnings (and cash flows) to service debt, expected dividends and to withstand unexpected shocks, and (c) earnings (and cash flows) are managed properly across geographies and are consistent with our funding strategies. The two measures we apply to monitor the volatility of our earnings are European Embedded Value (EEV) operating profit and International Financial Reporting Standards (IFRS) operating profit, although EEV and IFRS total profits are also considered.

(b) *Capital requirements*: the limits aim to ensure that (a) the Group meets its capital requirements at all times including EU Insurance Groups Directive (IGD) capital requirements, (b) the Group achieves its desired target rating to meet its business objectives, and (c) supervisory intervention is avoided. In addition, we also monitor capital requirements on a local statutory basis.

Our risk appetite framework forms an integral part of our annual business planning cycle. Our Group Risk function monitors the Group's risk profile against the agreed limits. Using submissions from business units, Group Risk calculates the Group's aggregated position (allowing for diversification effects between business units) relative to the limits implied by the risk appetite statements.

We use a two-tier approach to apply the limits at business unit level. Firstly, we calculate business unit risk limits. These ensure that, provided each business unit keeps within its limits, the Group risk position will remain within the Group limits. Secondly, the impact on the risk position is considered as part of Group Risk's scrutiny of large transactions or departures from plan proposed by individual business units.

In the event that the business unit plans imply risk limits will be exceeded, this will necessitate a dialogue between the executive and the relevant business unit or units. Exceeding Group limits may be avoided if, for example, limits in other business units are not fully utilised, or if the diversification effect at Group level of a particular risk with other business units means the Group limit is not breached.

Market risk is managed such that as conditions evolve the risk profile is maintained within risk appetite. In addition to business unit operational limits on credit risk, we set counterparty risk limits at Group level. The limits on our total Group-wide exposures to a single counterparty are specified within different credit rating 'categories'. The Group Risk and the Group Credit Risk Committee monitor our actual exposures against these limits on at least a monthly basis, escalating matters to Group Executive Risk Committee (GERC) as appropriate.

**Risk exposures**

The Group Risk Framework deploys a common risk language, allowing meaningful comparisons to be made between different business units. Risks are broadly categorised as shown below.

| Category | Risk type | Definition |
|---|---|---|
| Financial risks | Market risk | The risk that arises from adverse changes in the value of, or income from, assets and changes in interest rates or exchange rates. |
| | Credit risk | The risk of loss if another party fails to meet its obligations, or fails to do so in a timely fashion. |
| | Insurance risk | The inherent uncertainty as to the occurrence, amount and timing of insurance liabilities. This includes adverse mortality, morbidity and persistency experience. |
| | Liquidity risk | The risk that a business, though solvent on a balance sheet basis, either does not have the financial resources to meet its obligations as they fall due or can secure them only at excessive cost. |
| Non-financial risks | Operational risk | The risk of direct or indirect loss resulting from inadequate or failed internal processes, people or systems, or from external events. This includes legal and regulatory compliance risk. |
| | Business environment risk | Exposure to forces in the external environment that could significantly change the fundamentals that drive the business's overall objectives and strategy. |
| | Strategic risk | Ineffective, inefficient or inadequate senior management processes for the development and implementation of business strategy in relation to the business environment and the Group's capabilities. |

The key financial and non-financial risks and uncertainties faced by the Group, and our approaches to managing them, are described below.

**1 Financial risks**

***a Market risk***

i Equity risk

In the UK business, most of our equity exposure is incurred in the with-profits fund, which includes a large inherited estate estimated at £6.8 billion as at 31 December 2010 (2009: £6.4 billion), which can absorb market fluctuations and protect the fund's solvency. The inherited estate itself is partially protected against falls in equity markets through an active hedging policy.

In Asia, a high proportion of our in-force book is made up of unit-linked products with limited shareholder exposure to equities. We have minimal direct shareholder exposure to Asian equity markets outside our unit-linked holdings.

In the US, where we are a leading provider of variable annuities, there are well-understood risks associated with the guarantees embedded in our products. We provide guaranteed minimum death benefits (GMDB) on all policies in this class, guaranteed minimum withdrawal benefits (GMWB) on 64 per cent of the book, and guaranteed minimum income benefits (GMIB) on only six per cent. To protect the shareholders against the volatility introduced by these embedded options, we use both a comprehensive hedging programme and reinsurance. Due to the inability to economically reinsure or hedge the GMIB, Jackson ceased offering this benefit in 2009.

In our variable annuity sales activities, we focus on meeting the needs of conservative and risk averse customers who are seeking reliable income in retirement, and who display little tendency to arbitrage their guarantees. These customers generally select conservative investment options. We are able to meet the needs of these customers because our unique and market leading operational platform allows us to tailor more than 3,400 product combinations.

It is our philosophy not to compete on price. Our individual guarantees tend to be more expensive than the market average because we seek to sell at a price capable of funding the cost we incur to hedge or reinsure our risks.

We use a macro approach to hedging that covers the entire risk in the US business. Within this macro approach we make use of the natural offsets that exist between the variable annuity guarantees and the fixed index annuity book, and then use a combination of OTC options and futures to hedge the residual risk, allowing for significant market shocks and limiting the amount of capital we are putting at risk. Internal positions are generally netted before any external hedge positions are considered. The hedging programme also covers the fees on variable annuity guarantees.

Jackson hedges the economics of its products rather than the accounting result. This focus means that we sometimes accept a degree of variability in our accounting results in order to ensure we achieve the appropriate economic result. Accordingly, while its hedges are effective on an economic basis, due to different accounting treatment for the hedges and some of the underlying hedged items on an IFRS basis, the reported income effect is more variable. As previously highlighted this resulted in a negative net equity hedge accounting effect of £367 million in the period (net of related DAC amortisation) as compared to an equivalent negative effect of £159 million in 2009. During 2010 we reclassified these effects from operating profit based on longer-term investment returns to short-term fluctuations to ensure the Group's operating results better reflect Jackson's continued focus on optimising economic value.

ii Interest rate risk

Interest rate risk arises primarily from Prudential's investments in long-term debt and fixed income securities. Interest rate risk also exists in policies that carry investment guarantees on early surrender or at maturity, where claim values can become higher than the value of backing assets as a result of rises or falls in interest rates.

In the US there is interest rate risk across the portfolio. The majority of Jackson's fixed annuity and life liabilities allow for an annual reset of the crediting rate, which provides for a greater level of discretion in determining the amount of interest rate risk to assume. The primary concerns with these liabilities relate to potential surrenders when rates increase and, in a low interest environment, the minimum guarantees required by state law. With its large fixed annuity and fixed index annuity books, Jackson has natural offsets for its variable annuity interest rate related risks. Jackson manages interest rate exposure through a combination of interest rate swaps and interest rate options.

In the UK the investment policy for the shareholder-backed annuity business is to match the cash flows from investments with the annuity payments. As a result, assets and liabilities are closely matched by duration. The impact on profit of any residual cash flow mismatching can be adversely affected by changes in interest rates; therefore the mismatching position is regularly monitored.

The exposure to interest rate risk arising from Asia is at modest levels.

iii Foreign exchange risk

Prudential principally operates in the UK, the US, and in 13 countries in Asia. The geographical diversity of our businesses means that we are inevitably subject to the risk of exchange rate fluctuations. Prudential's international operations in the US and Asia, which represent a significant proportion of our operating profit and shareholders' funds, generally write policies and invest in assets denominated in local currency. Although this practice limits the effect of exchange rate fluctuations on local operating results, it can lead to significant fluctuations in our consolidated financial statements when results are expressed in pounds sterling.

We do not generally seek to hedge foreign currency revenues, as these are substantially retained locally to support the growth of the Group's business and meet local regulatory and market requirements. However, in cases where a surplus arising in an overseas operation supports Group capital or shareholders' interest, this exposure is hedged if it is economically optimal to do so. Currency borrowings, swaps and other derivatives are used to manage exposures.

### b *Credit risk*

In addition to business unit operational limits on credit risk, we monitor closely our counterparty exposures at Group level, highlighting those that are large or of concern. Where appropriate, we will reduce our exposure, purchase credit protection or make use of collateral arrangements to control our levels of credit risk.

Debt portfolio

Our debt portfolio on an IFRS basis was £116.4 billion at 31 December 2010. £54.0 billion of these assets backed shareholder business, of which 95 per cent were investment grade, compared to 93 per cent at 31 December 2009. Sovereign debt represented 16 per cent of the debt portfolio backing shareholder business, or £8.8 billion, at 31 December 2010. Exposures to sovereign debt have increased since December 2009 due mainly to an enlarged position in US Treasuries. Seventy three per cent of this was rated AAA and 93 per cent investment grade. Eurozone sovereign exposures backing shareholder business were £3.6 billion at 31 December 2010, of which 99 per cent were AAA rated. Of the remaining one per cent, the highest exposure was in respect of Italy (£52 million) and Spain (less than £1 million) whilst there was no sovereign exposure to Greece, Portugal or Ireland. The total banking exposure to Portugal, Ireland, Italy, Greece and Spain (PIIGS) was £363 million at 31 December 2010.

Asia

Asia's debt portfolio totalled £14.1 billion at 31 December 2010. Of this, approximately 69 per cent was in unit-linked and with-profits funds with minimal shareholders' risk. The remaining 31 per cent is shareholder exposure and is invested predominantly (84 per cent) in investment grade bonds. For Asia, the portfolio has performed very well, and did not experience any default losses in 2010.

UK

The UK's debt portfolio on an IFRS basis is £74.3 billion as at 31 December 2010, including £46.5 billion within the UK with-profits fund. Shareholders' risk exposure to the with-profits fund is limited as the solvency is protected by the large inherited estate. Outside the with-profits fund there is £6.0 billion in unit-linked funds where the shareholders' risk is limited, with the remaining £21.8 billion backing the shareholders' annuity business and other non-linked business (of which 80 per cent is rated AAA to A, 18 per cent BBB and two per cent non-investment grade).

On a statutory (Pillar 1) basis at 31 December 2010, we held prudent credit reserves within the UK shareholder annuity funds of £1.8 billion to allow for future credit risk. For Prudential Retirement Income Limited (PRIL) this allowance is set at 68 bps decrease in the valuation discount rate at 31 December 2010 (2009: 71 bps). This now represents 43 per cent of the portfolio spread over swaps compared to 41 per cent as at 31 December 2009. No defaults were reported on the debt portfolio held by the UK shareholder backed annuity business in 2010.

During 2010, we continued to materially reduce our holdings in subordinated financial debt backing our annuity business, improving the overall credit quality of our bond portfolios. This has resulted in gross losses of £104 million on shareholder-backed business and £62 million on policyholder backed business in the period. On a Pillar I basis these losses have been fully offset by a reduction in long-term default reserves of £98 million shareholder/£39 million policyholder that arose as a result of the improvement in the quality of our remaining bond portfolios and a further release of short-term default reserves of £6 million shareholder and £23 million policyholder, which were allocated to the assets sold. On an IFRS basis, the gross costs less the reduction in long-term and short-term default reserves resulted in a small overall pre-tax loss to operating profit of £4 million to shareholders and £15 million to policyholders.

US

The most significant area of exposure to credit risk for the shareholders is Jackson in the US. At 31 December 2010 Jackson's fixed income portfolio totalling £26.4 billion, comprised £20.2 billion corporate and government debt, £2.8 billion of Residential Mortgage Backed Securities (RMBS), £2.4 billion of Commercial Mortgage Backed Securities (CMBS) and £1 billion of other instruments.

The US corporate and government debt portfolio of £20.2 billion is comprised of £17.8 billion of corporate debt and £2.4 billion of government debt. Of the £17.8 billion of corporate debt 95 per cent is investment grade. Concentration risk within the corporate debt portfolio is low, with the top ten holdings accounting for approximately eight per cent of the portfolio. Our largest sector exposures in the investment grade corporate debt portfolio are Utilities and Energy at 16 per cent and 15 per cent respectively. We actively manage the portfolio and will sell exposures as events dictate.

Within the RMBS portfolio of £2.8 billion, the agency guaranteed portion is 55 per cent. Another 22 per cent of the portfolio is non-agency prime and Alt-A investments with pre-2006/2007 vintages, where experience has been much more positive than later vintages. Our exposure to the 2006/2007 vintages totals £424 million of which £413 million is invested in the senior part of the capital structure, thereby significantly reducing the risk of defaults and the magnitude of loss if a shortfall does occur. The actual exposure to non-senior 2006/2007 Prime and Alt-A RMBS is only £11 million. The total RMBS portfolio has an average fair value price of 88 cents on the dollar.
The CMBS portfolio of £2.4 billion is performing strongly, with 36 per cent of the portfolio rated AAA and one per cent rated below investment grade. The entire portfolio has an average credit enhancement level of 30 per cent. This level provides significant protection, since it means the bond has to incur a 30 per cent loss, net of recoveries, before we are at risk.

In Jackson, total amounts charged to profits relating to debt securities were £213 million (2009: £631 million). This is net of recoveries/reversals recognised in the year of £10 million (2009: £5 million).

In 2010, Jackson's total defaults were £nil (2009: less than £1 million). In addition, as part of our active management of the book, we incurred losses net of recoveries and reversals of £89 million (2009: less than £1 million) on credit related sales of impaired bonds.

IFRS write-downs excluding defaults for the year were £124 million compared to £630 million in 2009. Of this amount £71 million (2009: £509 million) was in respect of RMBS securities.

The impairment process reflects a rigorous review of every bond and security in our portfolio. Our accounting policy requires us to book full mark-to-market losses on impaired securities through our income statement. However we would expect only a proportion of these losses eventually to turn into defaults, and some of the impaired securities to recover in price over time.

Unrealised gains and losses on debt securities in the US
Jackson's net unrealised gains from debt securities has steadily improved from negative £2,897 million at 31 December 2008 to positive £4 million at 31 December 2009 to positive £1,210 million at 31 December 2010. The gross unrealised loss position moved from £966 million at 31 December 2009 to £370 million at 31 December 2010. Gross unrealised losses on securities priced at less than 80 per cent of face value totalled £224 million at 31 December 2010 compared to £594 million at 31 December 2009.

Asset management
The debt portfolio of the Group's asset management operations of £1.6 billion as at 31 December 2010 is principally related to Prudential Capital operations. Of this amount £1.5 billion were rated AAA to A- by S&P or Aaa by Moody's.

Loans
Of the total Group loans of £9.3 billion at 31 December 2010, £7.1 billion are held by shareholder-backed operations comprised of £4.7 billion commercial mortgage loans and £2.4 billion of other loans.

Of the £7.1 billion held by shareholder-backed operations, the Asian insurance operations held £0.5 billion of other loans, the majority of which are commercial loans held by the Malaysian operation that are rated investment grade by two local rating agencies. The US insurance operations held £4.2 billion of loans, comprising £3.6 billion of commercial mortgage loans, all of which are collateralised by properties, and £0.5 billion of policy loans. The US commercial mortgage loan portfolio does not include any single-family residential mortgage loans and therefore is not exposed to the risk of defaults associated with residential sub-prime mortgage loans. The UK insurance operations held £1.0 billion of loans, the majority of which are mortgage loans collateralised by properties.

The balance of the total shareholder loans amounts to £1.4 billion and relates to bridging loan finance managed by Prudential Capital.

***c Insurance risk***

The processes of determining the price of our products and reporting the results of our long-term business operations require us to make a number of assumptions. In common with other industry players, the profitability of our businesses depends on a mix of factors including mortality and morbidity trends, persistency, investment performance, unit cost of administration and new business acquisition expenses.

We continue to conduct rigorous research into longevity risk using data from our substantial annuity portfolio. The assumptions that Prudential makes about future expected levels of mortality are particularly relevant in its UK annuity business. The attractiveness of reinsurance is regularly evaluated. It is used as a risk management tool where it is appropriate and attractive to do so.

Prudential's persistency assumptions reflect recent experience for each relevant line of business, and any expectations of future persistency. Persistency risk is mitigated by appropriate training and sales processes and managed proactively post sale. Where appropriate, allowance is also made for the relationship – either assumed or historically observed – between persistency and investment returns, and for the resulting additional risk.

### *d Liquidity risk*

The holding company has significant internal sources of liquidity which are sufficient to meet all of our expected requirements for the foreseeable future without having to make use of external funding. In aggregate the Group has £2.1 billion of undrawn committed facilities, expiring between 2011 and 2015. In addition the Group has access to liquidity via the debt capital markets. Recent issues include a £250 million senior three-year MTN in 2010 and the US$550m perpetual subordinated tier 1 securities issued in January 2011. Prudential also has in place an unlimited commercial paper programme and has maintained a consistent presence as an issuer in this market for the last 10 years. Liquidity uses and sources have been assessed at a business unit level under base case and stressed assumptions. The liquidity resources available and the subsequent Liquidity Coverage Ratio (LCR) have been assessed to be sufficient under both sets of assumptions.

## 2 Non-financial risk

Prudential is exposed to operational, business environment and strategic risk in the course of running its businesses.

With regard to operational risk, the Group is dependent on processing a large number of complex transactions across numerous and diverse products, and is subject to a number of different legal and regulatory, including tax, regimes. Prudential also has a significant number of third-party relationships that are important to the distribution and processing of our products, both as market counterparties and as business partners. This results in reliance upon the operational performance of these outsourcing partners.

Prudential's systems and processes incorporate controls that are designed to manage and mitigate the operational risks associated with its activities. The Prudential Group Governance Manual was developed to make a key contribution to the sound system of internal control that the Group is expected to maintain under the Combined Code of Corporate Governance in the UK and the Hong Kong Code on Corporate Governance Practices. Business units confirm that they have implemented the necessary controls to evidence compliance with the Manual.

The Group also has an operational risk management framework in place that facilitates both the qualitative and quantitative analysis of operational risk exposures. The output of this framework, in particular management information on key operational risk components such as risk and control assessments, internal incidents and external incidents, is reported by the business operations and presented to the Group Operational Risk Committee. This information also supports business decision making and lessons learned activities; the ongoing improvement of the control environment; the informing of overall levels of capital held; and determination of the adequacy of Prudential's corporate insurance programme.

With regard to business environment risk, the Group has a wide-ranging programme of active and constructive engagement with governments, policymakers and regulators in our key markets and with relevant international institutions. Such engagement is undertaken both directly and indirectly via trade associations. The Group has procedures in place to monitor and track political and regulatory developments. Where appropriate, we provide submissions and technical input to officials and others, either via submissions to formal consultations or through interactions with officials.

With regard to strategic risk, both business operations and the corporate centre are required to adopt a forward-looking approach to risk management by performing risk assessments as part of the annual strategic planning process. This supports the identification of potential threats and the initiatives needed to address them, as well as competitive opportunities. The impact on the underlying businesses and/or Group-wide risk profile is also considered to ensure that strategic initiatives are within the Group's risk appetite.

## 3 Risk factors and contingencies

Our disclosures covering risk factors can be found at the end of this document. Note H14 of the IFRS basis condensed consolidated financial statements gives an update on the position for contingencies of the Group since those published in the 2009 Annual Report.

## Capital management

***Regulatory capital (IGD)***

Prudential is subject to the capital adequacy requirements of the European Union (EU) Insurance Groups Directive (IGD) as implemented by the Financial Services Authority (FSA) in the UK. The IGD capital adequacy requirements involve aggregating surplus capital held in our regulated subsidiaries, from which Group borrowings, except those subordinated debt issues that qualify as capital, are deducted. No credit for the benefit of diversification is permitted under this approach.

Our capital position remains strong. We have continued to place emphasis on maintaining the Group's financial strength through optimising the balance between writing profitable new business, conserving capital and generating cash. We estimate that our IGD capital surplus was £4.3 billion at 31 December 2010 (before taking into account the 2010 final dividend), covering our capital requirements 3.0 times. This compares to a capital surplus of £3.4 billion at the end of 2009 (before taking into account the 2009 final dividend).

The movements during 2010 mainly comprise:

- Net capital generation mainly through operating earnings (in-force releases less investment in new business) of £1.7 billion;
- Release of tax provisions of £0.2 billion;
- Foreign exchange movements of positive £0.1 billion;

Offset by:

- Final 2009 dividend, net of scrip, of £0.3 billion and interim 2010 dividend, net of scrip, of £0.1 billion;
- Inadmissible assets arising on the purchase of UOB's life insurance subsidiary in Singapore of £0.2 billion;
- Impact of costs incurred in relation to the terminated AIA acquisition, net of tax, of £0.3 billion; and
- External financing costs and other central costs, net of tax, of £0.2 billion.

We continue to have further options available to us to manage available and required capital. These could take the form of increasing available capital (for example, through financial reinsurance) or reducing required capital (for example, through the mix and level of new business) and the use of other risk mitigation measures such as hedging and reinsurance.

In addition to our strong capital position, on a statutory (Pillar 1) basis, the total credit reserve for the UK shareholder annuity funds also protects our capital position in excess of the IGD surplus. This credit reserve as at 31 December 2010 was £1.8 billion. This represents 43 per cent of the portfolio spread over swaps, compared to 41 per cent as at 31 December 2009.

*Stress Testing*

As at 31 December 2010 stress testing of our IGD capital position to various events has the following results:

- An instantaneous 20 per cent fall in equity markets from 31 December 2010 levels would reduce the IGD surplus by £200 million;
- A 40 per cent fall in equity markets (comprising an instantaneous 20 per cent fall followed by a further 20 per cent fall over a four week period) would reduce the IGD surplus by £650 million;
- A 150 bps reduction (subject to a floor of zero) in interest rates would reduce the IGD surplus by £500 million;
- Credit defaults of ten times the expected level would reduce IGD surplus by £550 million.

We believe that the results of these stress tests, together with the Group's strong underlying earnings capacity, our established hedging programmes and our additional areas of financial flexibility, demonstrate that we are in a position to withstand significant deterioration in market conditions.

We also use an economic capital assessment to monitor our capital requirements across the Group, allowing for realistic diversification benefits and continue to maintain a strong position. This assessment provides valuable insights into our risk profile.

### *Solvency II*

The European Union (EU) is developing a new solvency framework for insurance companies, referred to as 'Solvency II'. The Solvency II Directive, which sets out the new framework, was formally approved by the Economic and Financial Affairs Council in November 2009 and is expected to be implemented from 1 January 2013. The new approach is based on the concept of three pillars – minimum capital requirements, supervisory review of firms' assessments of risk, and enhanced disclosure requirements.

Specifically, Pillar 1 covers the quantitative requirements around own funds, valuation rules for assets and liabilities and capital requirements. Pillar 2 provides the qualitative requirements for risk management, governance and controls, including the requirement for insurers to submit an Own Risk and Solvency Assessment (ORSA) which will be used by the regulator as part of the supervisory review process. Pillar 3 deals with the enhanced requirements for supervisory reporting and public disclosure.

A key aspect of Solvency II is that the assessment of risks and capital requirements will be aligned more closely with economic capital methodologies. Companies may be allowed to make use of internal economic capital models if approved by the local regulator.

The European Commission is in the process of consulting on the detailed rules that complement the high-level principles in the Directive, referred to as 'implementing measures', which are not expected to be finalised before late 2011.

In particular, the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) published a number of consultation papers in 2009 and 2010 covering advice to the European Commission on the implementing measures but there remains significant uncertainty regarding the outcome from this process. Prudential is actively participating in shaping the outcome through our involvement in industry bodies and trade associations, including the Chief Risk Officer and Chief Financial Officer Forums, together with the Association of British Insurers (ABI) and the Comité Européen des Assurances (CEA). In addition, further guidance and technical standards are currently being developed by the European Insurance and Occupational Pensions Authority (EIOPA). These are expected to be subject to a formal consultation in mid-2011 and finalised by early 2012.

Many of the issues being actively debated have received considerable focus both within the industry and from national bodies. However, the application of Solvency II to international groups is still unclear and there remains a risk of inconsistent application, which may place Prudential at a competitive disadvantage to other European and non-European financial services groups. There is also a risk that the effect of the measures finally adopted could be adverse for the Group, including potentially a significant increase in capital required to support its business.

Having assessed the high-level requirements of Solvency II, an implementation programme was initiated with dedicated teams to manage the required work across the Group. The activity of the local Solvency II teams is being coordinated centrally to achieve consistency in the understanding and application of the requirements.

Over the coming months we will be progressing our implementation plans further and remaining in regular contact with the FSA as we continue to engage in the 'pre-application' stage of the approval process for the internal model.

### *Capital allocation*

Prudential's approach to capital allocation takes into account a range of factors, especially risk adjusted returns on capital, the impact of alternative capital measurement bases (accounting, regulatory, economic and ratings agency assessments), tax efficiency, and wider strategic objectives.

We optimise capital allocation across the Group by using a consistent set of capital performance metrics across all business units to ensure meaningful comparison. Capital utilisation, return on capital and new business value creation are measured at a product level. The use of these capital performance metrics is embedded into our decision-making processes for product design and product pricing.

Our capital performance metrics are based on economic capital, which provides a view of our capital requirements across the Group, allowing for realistic diversification benefits. Economic capital also provides valuable insights into our risk profile and is used both for risk measurement and capital management.

***Risk mitigation and hedging***

We manage our actual risk profile against our tolerance of risk. To do this, we maintain risk registers that include details of the risks we have identified and of the controls and mitigating actions we employ in managing them. Any mitigation strategies involving large transactions – such as a material derivative transaction – are subject to review at Group level before implementation.

We use a range of risk management and mitigation strategies. The most important of these include: adjusting asset portfolios to reduce investment risks (such as duration mismatches or overweight counterparty exposures); using derivatives to hedge market risks; implementing reinsurance programmes to limit insurance risk; implementing corporate insurance programmes to limit the impact of operational risks; and revising business plans where appropriate.

## OTHER CORPORATE INFORMATION

**Products and drivers of insurance operations' profits**

### Overview of the Group's principal activities

Prudential plc is the holding company of the Prudential Group. The principal activity of our subsidiary operations is the provision of financial services to individuals and businesses in Asia, the US and UK. We offer a wide range of retail financial products and services and asset management services throughout these territories. The retail financial products and services principally include life insurance, pensions and annuities as well as collective investment schemes.

**Asia**
The life insurance products offered by Prudential Corporation Asia include with-profits (participating) and non-participating term, whole life and endowment and unit-linked policies. To supplement our life products we also offer health, disablement, critical illness and accident cover.

The primary focus in Asia is regular premium products that provide both savings and protection benefits.

In 2010, the new business profit mix in our Asian insurance business was derived 59 per cent (2009: 56 per cent) from health and protection products, 32 per cent (2009: 31 per cent) from unit-linked products and nine per cent (2009: 13 per cent) from non-linked products.

Unit-linked products combine savings with protection, with the cash value of the policy depending on the value of the underlying unitised funds. Participating products provide savings with protection where the basic sum assured can be enhanced by a profit share (or bonus) from the underlying fund as determined at the discretion of the insurer. Non-participating products offer savings with protection where the benefits are guaranteed or determined by a set of defined market-related parameters. Accident and health products provide mortality or morbidity benefits and include health, disablement, critical illness and accident cover. These products are commonly offered as supplements to main life policies, but can also be sold separately.

Policyholder and insurer share the profits from participating policies (typically in a 90:10 ratio) in the same way as with-profits business in the UK. With unit-linked products, shareholders receive the profits arising from managing the policy, its investments and the insurance risk. Policyholders within the underlying unitised fund receive investment gains. The profits from accident and health and non-participating products come from any surplus remaining after paying policy benefits.

Unit-linked products tend to have higher profits on the EEV basis of reporting than traditional non-linked products, as expenses and charges are better matched and solvency capital requirements are lower. At the end of 2010, we were offering unit-linked products in 10 of the 11 countries in Asia in which we operate, with the only exception being Thailand.

In Malaysia and Indonesia, Prudential also offers life insurance policies that are constructed to comply with Islamic principles otherwise known as Takaful. The main principles are policyholders co-operate amongst themselves for the common good, uncertainty is eliminated in respect of subscription and compensation and there is no investment in prohibited areas such as gambling or alcohol.

In addition to the life products described above, we offer mutual fund investment products in India, Taiwan, Japan, Singapore, Malaysia, Hong Kong, Korea, Vietnam and China, thus enabling customers to participate in debt, equity and money market investments. We are also licensed in the United Arab Emirates. Prudential Corporation Asia earns a fee based on assets under management.

**United States**
Jackson's product offerings include variable, fixed and fixed index annuities, as well as life insurance and institutional products.

Annuities
Annuity products are long-term individual retirement products, which offer tax-deferred accumulation on the funds invested until proceeds are withdrawn from the policy.

Fixed annuities are used for asset accumulation in retirement planning and for providing income in retirement and offer flexible payout options. The contract holder pays us a premium, which is credited to the contract holder's account. Periodically, interest is credited to the contract holder's account and administrative charges are deducted. The interest rate may be reset on each contract anniversary, subject to a guaranteed minimum, in line with state regulations. When the annuity matures, the contract holder is paid either the amount in the contract holder account or staggered payments in the form of an immediate annuity – similar to a UK annuity in payment.

Fixed annuity policies are subject to early surrender charges for the first six to nine years of the contract. In addition, the contract may be subject to a market value adjustment at the time of surrender. During the surrender charge period, the contract holder may cancel the contract for the surrender value. Our profits on fixed annuities come primarily from the spread between the return earned on investments and the interest credited to the contract holder's account, less expenses. Fixed annuities continue to be a profitable book of business, benefiting from favourable spread income in recent years.

Fixed index annuities are similar to fixed annuities, in that the contract holder pays a premium that is credited to the contract holder's account, and also in that interest is periodically credited to the contract holder's account. An annual minimum interest rate is guaranteed, although actual interest credited may be higher and is linked to an equity index over the product's index option period. Profit comes primarily from the spread between the return earned on investments and the amounts credited to the contract holder's account, less expenses, which include the costs of hedging the equity component of the interest credited to the contract. As previously described, hedge results are reflected in short-term fluctuations. Fixed index annuities are subject to early surrender charges for the first five to twelve years of the contract. During the surrender charge period, the contract holder may cancel the contract for the surrender value. Fixed index annuities continue to be a profitable product, benefiting from favourable spread and the effective management of equity risk. The fixed index book provides natural offsetting equity exposure to the guarantees issued in connection with our variable annuity products, which allows for efficient hedging of the net equity exposure.

Variable annuities are tax-advantaged, deferred annuities where the rate of return depends upon the performance of the underlying investment portfolio, similar in principle to UK unit-linked products. They are also used for asset accumulation in retirement planning and to provide income in retirement.

The contract holder can allocate the premiums between a variety of variable sub-accounts, with a choice of fund managers and/or guaranteed fixed-rate options. As with a unit-linked fund, the contract holder's premiums allocated to the variable accounts are held separately from Jackson's general account assets. The value of the portion of the separate account allocated to variable sub-accounts fluctuates with the underlying investments. Variable annuity policies are subject to early surrender charges for the first four to seven years of the contract. During the surrender charge period, the contract holder may cancel the contract for the surrender value. Jackson offers one variable annuity that has no surrender charges and also offers a choice of guaranteed benefit options within their variable annuity product portfolio, which customers can elect and pay for. These options include the guaranteed minimum death benefit (GMDB), which guarantees that, upon death of the annuitant, the contract holder or beneficiary receives a minimum value regardless of past market performance. These guaranteed death benefits might be expressed as the return of original premium, the highest past anniversary value of the contract, or as the original premium accumulated at a fixed rate of interest. In addition, there are three other types of guarantees: guaranteed minimum withdrawal benefits (GMWB), guaranteed minimum accumulation benefits (GMAB) and guaranteed minimum income benefits (GMIB). Due to the lack of availability to economically reinsure or hedge new issues of GMIB, Jackson discontinued offering it in 2009.

GMWBs provide a guaranteed return of the principal invested by allowing for periodic withdrawals that are limited to a maximum percentage of the initial premium. One version of the GMWBs provides for a minimum annual withdrawal amount that is guaranteed for the contract holder's life without annuitisation. Variations of the GMWBs are offered whereby the guaranteed base can be increased, either through step-ups to a more recent market value of the account, or through bonuses offered if withdrawals are delayed for a particular number of years. Additional charges are assessed for these features. GMABs generally provide a guarantee for a return of a certain amount of principal after a specified period. GMIBs provide for a minimum level of benefits upon annuitisation regardless of the value of the investments underlying the contract at the time of annuitisation. The GMIB is reinsured.

As the investment return on the separate account assets is attributed directly to the contract holders, Jackson's profit arises from the fees charged on the contracts, less the expenses incurred, which include the costs of hedging the guarantees. As previously described, hedge results are reflected in short-term fluctuations. In addition to being a profitable book of business in its own right, the variable annuity book also provides an opportunity to utilise the offsetting equity risk among various lines of business to cost effectively manage our equity exposure. It is believed that the internal management of equity risk, coupled with the use of external derivative instruments where necessary, continues to provide a cost-effective method of managing equity exposure. Profits in the variable annuity book of business will continue to be subject to the impact of market movements on both sales and allocations to the variable accounts and the effects of the economic hedging programme. While risk is hedged on an economic basis, the nature and duration of the hedging instruments, which are recorded at fair value through the income statement, will fluctuate and produce some accounting volatility. Management continues to believe that, on a long-term economic basis, the equity exposure remains well managed.

Life insurance
Jackson also sells several types of life insurance including term life, universal life and variable universal life. Term life provides protection for a defined period of time and a benefit that is payable to a designated beneficiary upon the insured's death. Universal life provides permanent individual life insurance for the life of the insured and includes a savings element. Variable universal life is a life insurance policy that combines death benefit protection and the important tax advantages of life insurance with the long-term growth potential of professionally managed investments. The Jackson life insurance book has also delivered consistent profitability, driven primarily by favourable mortality experience.

Institutional products
Jackson's institutional products division markets institutional products such as traditional Guaranteed Investment Contracts (GICs), Funding Agreements and Medium Term Note (MTN) funding agreements. The institutional product offerings also include Jackson's funding agreements issued to the Federal Home Loan Bank. Institutional products are distributed directly to investors, through investment banks, or through funding agreement brokers. Jackson sold no institutional products during 2010 or 2009, as available capital was directed to support higher-margin variable annuity sales.

**United Kingdom**
In common with other UK long-term insurance companies, Prudential UK's products are structured as either with-profits (or participating) products, or non-participating products including annuities in payment and unit-linked products. Depending on the structure, the level of shareholders' interest in the value of policies and the related profit or loss varies.

With-profits policies are supported by a with-profits sub-fund and can be single premium (for example, Onshore Bonds or Flexible Investment Bonds) or regular premium (for example, certain pension products).

The primary with-profits sub-fund is part of The Prudential Assurance Company Limited (PAC)'s long-term fund. The return to shareholders on virtually all with-profits products is in the form of a statutory transfer to PAC shareholders' funds. This is analogous to a dividend from PAC's long-term fund, and is dependent upon the bonuses credited or declared on policies in that year. In this context, there are two types of bonuses – 'regular' and 'final'. Regular bonuses are declared regularly, usually once a year, and are determined as a prudent proportion of the long-term expected future investment return on the underlying assets. Once credited, regular bonuses are guaranteed in accordance with the terms of the particular product. In contrast, 'final' bonuses are only guaranteed until the next bonus declaration, and are primarily determined on the actual smoothed investment return achieved over the life of the policy. Prudential's with-profits policyholders currently receive 90 per cent of the distribution from the main with-profits sub-fund as bonus additions to their policies, while shareholders receive 10 per cent as a statutory transfer.

The Defined Charge Participating Sub-Fund (DCPSF) forms part of the PAC long-term fund. It is comprised of the accumulated investment content of premiums paid in respect of the defined charge participating with-profits business issued in France, the defined charge participating with-profits business reassured into PAC from Prudential International Assurance plc and Canada Life (Europe) Assurance Ltd and includes the portfolio of with-profit annuity policies acquired from Equitable Life in 2007. All profits in this fund accrue to policyholders in the DCPSF.

The profits from almost all of the new non-participating business accrue solely to shareholders. Such business is written in the non-profit sub-fund within PAC's long-term fund, or in various shareholder-owned direct or indirect subsidiaries. The most significant of these is Prudential Retirement Income Limited (PRIL), which also writes all new immediate annuities arising from vesting deferred annuity policies in the with-profits sub-fund of PAC.

There is a substantial volume of in-force non-participating business in PAC's with-profits sub-fund and that fund's wholly owned subsidiary Prudential Annuities Limited (PAL), which is closed to new business. Profits from this business accrue to the with-profits sub-fund.

**Description of EEV basis reporting**

Prudential's results are prepared on two accounting bases – the supplementary EEV basis, and the IFRS basis for the financial statements. Over the life of any given product, the total profit recognised will be the same under either the IFRS or the EEV basis. However, the two methods recognise the emergence of that profit in different ways, with profits emerging earlier under the EEV basis than under IFRS. This section explains how EEV differs from IFRS and why it is used.

In broad terms, IFRS profits for long-term business reflect the aggregate of statutory transfers from UK-style with-profits funds and profit on a traditional accounting basis for other long-term business. By their nature, the products sold by the life insurance industry are long-term, as insurance companies commit to service these products for many years into the future. The profit on these insurance sales is generated over this long-term period. In our view, the result under IFRS does not properly reflect the inherent value of these future profits, as it focuses instead on the amounts accruing to shareholders in the current year.

In May 2004 the CFO Forum, representing the Chief Financial Officers of 19 European insurers, published the European Embedded Value Principles (expanded by the Additional Guidance of EEV Disclosures published in October 2005), that provide consistent definitions, a framework for setting actuarial assumptions, and a more explicit approach to the underlying methodology and disclosures. So for example:

- The allowance for risk is explicit for EEV through: (i) an allowance for the cost of capital (at the higher of economic capital and the local statutory minimum) (ii) stochastic or other appropriate modelling of financial options and guarantees to ensure that an allowance for their cost is irrespective of their value at the balance sheet date, and (iii) an explicit allowance in the risk discount rate for financial and non-financial risks;
- EEV specifically allows for the look-through into profits arising in shareholder service companies, most notably the profit arising in investment management companies from managing the insurance companies funds for covered business;
- There are extensive disclosures required for EEV on all aspects of the calculations, including the methodology adopted and the analysis of return.

It is thought that the EEV basis not only provides a good indication of the value being added by management in a given accounting period, but also helps demonstrate whether shareholder capital is being deployed to best effect. Indeed insurance companies in many countries use comparable bases of accounting for management purposes.

The EEV basis is a value-based method of reporting in that it reflects the change in value of the business over the accounting period. This value is called the shareholders' funds on the EEV basis which, at a given point in time, is the value of future profits expected to arise from the current book of long-term insurance business plus the net worth of the company. In determining these expected profits, full allowance is made for the risks attached to their emergence and the associated cost of capital, and takes into account recent experience in assessing likely future persistency, mortality and expenses.

The change in value is typically analysed into the following components:

- the value added from new business sold during the year;
- the change in value from existing business already in place at the start of the year;
- short-term fluctuations in investment returns;
- change in economic assumptions;
- change in the time value of cost of options and guarantees and economic assumption changes;
- other items (for example, profit from other Group operations, tax, foreign exchange, exceptional items); and
- dividends.

The value added from new business – defined as the present value of the future profits arising from new business written in the year – is a key metric used in the management of our business. The change in value of business in force at the start of the year demonstrates how the existing book is being managed. Together, these metrics provide management and shareholders with valuable information about the underlying development of the Group's business and the success or otherwise of management actions.

EEV basis results are prepared by first of all setting 'best estimate' assumptions, by product, for all relevant factors including expenses, surrender levels and mortality. Economic assumptions as to future investment returns and inflation are generally based on a combination of market data and long-term assumptions. These assumptions are used to project future cash flows. The present value of the future cash flows is then calculated using a discount rate which reflects both the time value of money and the risks associated with the cash flows. The risk discount rate is determined by adding a risk margin to the appropriate risk free rate of return. The actual outcome may differ from that projected, in which case the effect will be reflected in the experience variances for that year.

The assumptions used for the EEV basis of accounting are set out in the notes that accompany the supplementary EEV basis information. An indication of the sensitivity of the results to changes in key assumptions is also provided within that information.

## CORPORATE GOVERNANCE

**Hong Kong listing obligations**

The directors confirm that from the date of listing of 25 May 2010, the Company has complied with the provisions of Appendix 14 of the Listing Rules of the Hong Kong Stock Exchange. The directors also confirm that the results have been reviewed by the Group Audit Committee.

The Board further confirms that it has complied with the Code on Corporate Governance Practices in Appendix 14 to the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited from the date of listing on the exchange, except that it has deviated in respect of the Terms of Reference of the Remuneration Committee. The remit of the Remuneration Committee is limited to considering the remuneration of the Chairman and executive directors and does not extend to making recommendations to the Board in respect of the remuneration of the non-executive directors. The reason for the deviation is that it would be counter to the principles of the Combined Code 2008 (and the provisions of the new UK Corporate Governance Code) for the Remuneration Committee to be involved in setting the fees of non-executive directors.

**IFRS Disclosure**
**PRUDENTIAL PLC 2010 RESULTS**

**International Financial Reporting Standards (IFRS) basis results**

## STATUTORY BASIS RESULTS

## INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) BASIS RESULTS

### CONSOLIDATED INCOME STATEMENT

| | **2010** | 2009 |
|---|---|---|
| | £m | £m |
| Gross premiums earned | **24,568** | 20,299 |
| Outward reinsurance premiums | **(357)** | (323) |
| Earned premiums, net of reinsurance | **24,211** | 19,976 |
| Investment return | **21,769** | 26,889 |
| Other income | **1,666** | 1,234 |
| Total revenue, net of reinsurance | **47,646** | 48,099 |
| Benefits and claims | **(40,608)** | (39,901) |
| Outward reinsurers' share of benefit and claims | **335** | 265 |
| Movement in unallocated surplus of with-profits funds | **(245)** | (1,559) |
| Benefits and claims and movement in unallocated surplus of with-profits funds, net of reinsurance | **(40,518)** | (41,195) |
| Acquisition costs and other expenditure (note I) | **(4,799)** | (4,572) |
| Finance costs: interest on core structural borrowings of shareholder-financed operations | **(257)** | (209) |
| Loss on sale of Taiwan agency business (note J) | **-** | (559) |
| Total charges, net of reinsurance | **(45,574)** | (46,535) |
| | | |
| Profit before tax *(being tax attributable to shareholders' and policyholders' returns)** | **2,072** | 1,564 |
| Tax charge attributable to policyholders' returns | **(611)** | (818) |
| Profit before tax attributable to shareholders (note C) | **1,461** | 746 |
| Tax charge (note K) | **(636)** | (873) |
| Less: tax attributable to policyholders' returns | **611** | 818 |
| Tax charge attributable to shareholders' returns*** (note K) | **(25)** | (55) |
| Profit from continuing operations after tax | **1,436** | 691 |
| Discontinued operations (net of tax)** | **-** | (14) |
| **Profit for the year** | **1,436** | 677 |
| Attributable to: | | |
| Equity holders of the Company | **1,431** | 676 |
| Non-controlling interests | **5** | 1 |
| **Profit for the year** | **1,436** | 677 |

| **Earnings per share (in pence)** | **2010** | 2009 |
|---|---|---|
| Basic: | | |
| Based on profit from continuing operations attributable to the equity holders of the Company (note L) | **56.7 p** | 27.6 p |
| Based on loss from discontinued operations attributable to the equity holders of the Company | **-** | (0.6)p |
| | **56.7 p** | 27.0 p |
| Diluted: | | |
| Based on profit from continuing operations attributable to the equity holders of the Company (note L) | **56.6 p** | 27.6 p |
| Based on loss from discontinued operations attributable to the equity holders of the Company | **-** | (0.6)p |
| | **56.6 p** | 27.0 p |

| **Dividends per share (in pence)** | **2010** | 2009 |
|---|---|---|
| Dividends relating to reporting year: | | |
| Interim dividend (2010 and 2009) | **6.61 p** | 6.29 p |
| Final/Second interim dividend (2010 and 2009) | **17.24 p** | 13.56 p |
| Total | **23.85 p** | 19.85 p |
| Dividends declared and paid in reporting year: | | |
| Current year interim dividend | **6.61 p** | 6.29 p |
| Second interim/final dividend for prior year | **13.56 p** | 12.91 p |
| Total | **20.17 p** | 19.20 p |

*This measure is the formal profit before tax measure under IFRS but it is not the result attributable to shareholders and is stated after £377 million of pre-tax costs of the terminated AIA transaction. See note G.
**The 2009 charge of £14 million which was net of £nil tax, reflected completion adjustments for a previously disposed business.
***The 2010 tax charge attributable to shareholders' return includes an exceptional tax credit of £158 million which primarily relates to the impact of a settlement agreed with the UK tax authorities.

## INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) BASIS RESULTS

### CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

| | **2010** | 2009 |
|---|---|---|
| | **£m** | £m |
| **Profit for the year** | **1,436** | 677 |
| **Other comprehensive income:** | | |
| Exchange movements on foreign operations and net investment hedges: | | |
| Exchange movements arising during the year | **217** | (206) |
| Related tax | **34** | 11 |
| | **251** | (195) |
| Available-for-sale securities: | | |
| Unrealised valuation movements on securities of US insurance operations classified as available-for-sale: | | |
| Unrealised holding gains arising during the year | **1,170** | 2,249 |
| Add back net losses included in the income statement on disposal and impairment | **51** | 420 |
| Total (note V) | **1,221** | 2,669 |
| Related change in amortisation of deferred income and acquisition costs | **(496)** | (1,069) |
| Related tax | **(247)** | (557) |
| | **478** | 1,043 |
| **Other comprehensive income for the year, net of related tax** | **729** | 848 |
| **Total comprehensive income for the year** | **2,165** | 1,525 |
| Attributable to: | | |
| Equity holders of the Company | **2,160** | 1,524 |
| Non-controlling interests | **5** | 1 |
| **Total comprehensive income for the year** | **2,165** | 1,525 |

## INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) BASIS RESULTS

### CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

| | 2010 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Share capital £m | Share premium £m | Retained earnings £m | Translation reserve £m | Available -for-sale securities reserve £m | Shareholders' equity £m | Non- controlling interests £m | Total equity £m |
| **Reserves** | | | | | | | | |
| Profit for the year | - | - | 1,431 | - | - | 1,431 | 5 | 1,436 |
| Other comprehensive income | | | | | | | | |
| Exchange movements on foreign operations and net investment hedges, net of related tax | - | - | - | 251 | - | 251 | - | 251 |
| Unrealised valuation movements, net of related change in amortisation of deferred income and acquisition costs and related tax | - | - | - | - | 478 | 478 | - | 478 |
| Total other comprehensive income | - | - | - | 251 | 478 | 729 | - | 729 |
| Total comprehensive income for the year | - | - | 1,431 | 251 | 478 | 2,160 | 5 | 2,165 |
| Dividends | - | - | (511) | - | - | (511) | - | (511) |
| Reserve movements in respect of share-based payments | - | - | 37 | - | - | 37 | - | 37 |
| Change in non-controlling interests arising principally from purchase and sale of property partnerships of the PAC with-profits fund and other consolidated investment funds | - | - | - | - | - | - | 7 | 7 |
| **Share capital and share premium** | | | | | | | | |
| New share capital subscribed (including shares issued in lieu of cash dividends) | - | 75 | - | - | - | 75 | - | 75 |
| Reserve movements in respect of shares issued in lieu of cash dividends | - | (62) | 62 | - | - | - | - | - |
| **Treasury shares** | | | | | | | | |
| Movement in own shares in respect of share-based payment plans | - | - | (4) | - | - | (4) | - | (4) |
| Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS | - | - | 3 | - | - | 3 | - | 3 |
| Net increase in equity | - | 13 | 1,018 | 251 | 478 | 1,760 | 12 | 1,772 |
| At beginning of year | 127 | 1,843 | 3,964 | 203 | 134 | 6,271 | 32 | 6,303 |
| **At end of year** | 127 | 1,856 | 4,982 | 454 | 612 | 8,031 | 44 | 8,075 |

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

| | 2009 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Share capital £m | Share premium £m | Retained earnings £m | Translation reserve £m | Available -for-sale securities reserve £m | Shareholders' equity £m | Non-controlling interests £m | Total equity £m |
| **Reserves** | | | | | | | | |
| Profit for the year | - | - | 676 | - | - | 676 | 1 | 677 |
| Other comprehensive income (loss) | | | | | | | | |
| Exchange movements on foreign operations and net investment hedges, net of related tax | - | - | - | (195) | - | (195) | - | (195) |
| Unrealised valuation movements, net of related change in amortisation of deferred income and acquisition costs and related tax | - | - | - | - | 1,043 | 1,043 | - | 1,043 |
| Total other comprehensive income (loss) | - | - | - | (195) | 1,043 | 848 | - | 848 |
| Total comprehensive income (loss) for the year | - | - | 676 | (195) | 1,043 | 1,524 | 1 | 1,525 |
| Dividends | - | - | (481) | - | - | (481) | - | (481) |
| Reserve movements in respect of share-based payments | - | - | 29 | - | - | 29 | - | 29 |
| Change in non-controlling interests arising principally from purchase and sale of property partnerships of the PAC with-profits fund and other consolidated investment funds | - | - | - | - | - | - | (24) | (24) |
| **Share capital and share premium** | | | | | | | | |
| New share capital subscribed (including shares issued in lieu of cash dividends) | 2 | 139 | - | - | - | 141 | - | 141 |
| Reserve movements in respect of shares issued in lieu of cash dividends | - | (136) | 136 | - | - | - | - | - |
| **Treasury shares** | | | | | | | | |
| Movement in own shares in respect of share-based payment plans | - | - | 3 | - | - | 3 | - | 3 |
| Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS | - | - | (3) | - | - | (3) | - | (3) |
| Net increase (decrease) in equity | 2 | 3 | 360 | (195) | 1,043 | 1,213 | (23) | 1,190 |
| At beginning of year | 125 | 1,840 | 3,604 | 398 | (909) | 5,058 | 55 | 5,113 |
| **At end of year** | 127 | 1,843 | 3,964 | 203 | 134 | 6,271 | 32 | 6,303 |

## INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) BASIS RESULTS

### CONSOLIDATED STATEMENT OF FINANCIAL POSITION

| | **2010** | 2009 |
|---|---|---|
| | **£m** | £m |
| **Assets** | | |
| Intangible assets attributable to shareholders: | | |
| Goodwill (note Q) | **1,466** | 1,310 |
| Deferred acquisition costs and other intangible assets (note R) | **4,609** | 4,049 |
| Total | **6,075** | 5,359 |
| | | |
| Intangible assets attributable to with-profits funds: | | |
| In respect of acquired subsidiaries for venture fund and other investment purposes | **166** | 124 |
| Deferred acquisition costs and other intangible assets | **110** | 106 |
| Total | **276** | 230 |
| Total | **6,351** | 5,589 |
| | | |
| Other non-investment and non-cash assets: | | |
| Property, plant and equipment | **612** | 367 |
| Reinsurers' share of insurance contract liabilities | **1,344** | 1,187 |
| Deferred tax assets (note K) | **2,188** | 2,708 |
| Current tax recoverable | **555** | 636 |
| Accrued investment income | **2,668** | 2,473 |
| Other debtors | **903** | 762 |
| Total | **8,270** | 8,133 |
| | | |
| Investments of long-term business and other operations: | | |
| Investment properties | **11,247** | 10,905 |
| Investments accounted for using the equity method | **71** | 6 |
| Financial investments*: | | |
| Loans (note T) | **9,261** | 8,754 |
| Equity securities and portfolio holdings in unit trusts | **86,635** | 69,354 |
| Debt securities (note U) | **116,352** | 101,751 |
| Other investments | **5,779** | 5,132 |
| Deposits | **9,952** | 12,820 |
| Total | **239,297** | 208,722 |
| | | |
| Properties held for sale | **257** | 3 |
| Cash and cash equivalents | **6,631** | 5,307 |
| **Total assets** (note N) | **260,806** | 227,754 |

*Included within financial investments are £8,708 million (2009: £10,501 million) of lent securities.

| | 2010 £m | 2009 £m |
|---|---|---|
| **Equity and liabilities** | | |
| **Equity** | | |
| Shareholders' equity | **8,031** | 6,271 |
| Non-controlling interests | **44** | 32 |
| Total equity | **8,075** | 6,303 |
| **Liabilities** | | |
| Policyholder liabilities and unallocated surplus of with-profits funds: | | |
| Insurance contract liabilities | **171,291** | 145,713 |
| Investment contract liabilities with discretionary participation features | **25,732** | 24,880 |
| Investment contract liabilities without discretionary participation features | **17,704** | 15,805 |
| Unallocated surplus of with-profits funds | **10,253** | 10,019 |
| Total | **224,980** | 196,417 |
| Core structural borrowings of shareholder-financed operations: | | |
| Subordinated debt | **2,718** | 2,691 |
| Other | **958** | 703 |
| Total (note W) | **3,676** | 3,394 |
| Other borrowings: | | |
| Operational borrowings attributable to shareholder-financed operations (note X) | **3,004** | 2,751 |
| Borrowings attributable to with-profits operations (note X) | **1,522** | 1,284 |
| Other non-insurance liabilities: | | |
| Obligations under funding, securities lending and sale and repurchase agreements | **4,199** | 3,482 |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | **3,372** | 3,809 |
| Deferred tax liabilities (note K) | **4,224** | 3,872 |
| Current tax liabilities | **831** | 1,215 |
| Accruals and deferred income | **707** | 594 |
| Other creditors | **2,321** | 1,612 |
| Provisions | **729** | 643 |
| Derivative liabilities | **2,037** | 1,501 |
| Other liabilities | **1,129** | 877 |
| Total | **19,549** | 17,605 |
| Total liabilities | **252,731** | 221,451 |
| **Total equity and liabilities** (note N) | **260,806** | 227,754 |

## INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) BASIS RESULTS

### CONSOLIDATED STATEMENT OF CASH FLOWS

| | 2010 £m | 2009 £m |
|---|---|---|
| **Cash flows from operating activities** | | |
| Profit before tax *(being tax attributable to shareholders' and policyholders' returns)*(note (i)) | **2,072** | 1,564 |
| Loss before tax from discontinued operations | **-** | (14) |
| Total profit before tax | **2,072** | 1,550 |
| Changes in operating assets and liabilities: | | |
| Investments | **(24,594)** | (26,388) |
| Other non-investment and non-cash assets | **(1,161)** | (384) |
| Policyholder liabilities (including unallocated surplus) | **24,287** | 24,932 |
| Other liabilities (including operational borrowings) | **1,332** | (299) |
| Interest income and expense and dividend income included in result before tax | **(7,514)** | (7,267) |
| Other non-cash items (note (ii)) | **139** | 650 |
| Operating cash items: | | |
| Interest receipts | **6,277** | 5,734 |
| Dividend receipts | **1,412** | 1,780 |
| Tax paid | **(302)** | (200) |
| Net cash flows from operating activities | **1,948** | 108 |
| **Cash flows from investing activities** | | |
| Purchases of property, plant and equipment | **(93)** | (91) |
| Proceeds from disposal of property, plant and equipment | **4** | 54 |
| Completion adjustment for previously disposed business | **-** | (20) |
| Disposal of Taiwan agency business (notes (iii) and J) | **-** | (497) |
| Acquisition of subsidiaries, net of cash balance (note (iv)) | **(145)** | - |
| Net cash flows from investing activities | **(234)** | (554) |
| **Cash flows from financing activities** | | |
| Structural borrowings of the Group: | | |
| Shareholder-financed operations (notes (v) and W): | | |
| Issue of subordinated debt, net of costs | **-** | 822 |
| Redemption of senior debt | **-** | (249) |
| Bank loan | **250** | - |
| Interest paid | **(251)** | (207) |
| With-profits operations (notes (vi) and X): | | |
| Interest paid | **(9)** | (9) |
| Equity capital (note (vii)): | | |
| Issues of ordinary share capital | **13** | 3 |
| Dividends paid | **(449)** | (344) |
| Net cash flows from financing activities | **(446)** | 16 |
| Net increase (decrease) in cash and cash equivalents | **1,268** | (430) |
| Cash and cash equivalents at beginning of year | **5,307** | 5,955 |
| Effect of exchange rate changes on cash and cash equivalents | **56** | (218) |
| Cash and cash equivalents at end of year | **6,631** | 5,307 |

**Notes**

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

(ii) The figure of £650 million for other non-cash items in 2009 includes £559 million for the loss on disposal of the Taiwan agency business.

(iii) The amount of £497 million for full year 2009 in respect of the disposal of the Taiwan agency business shown above, represents the cash and cash equivalents of £388 million held by Taiwan agency business transferred on disposal and restructuring costs of £64 million. In addition, the cashflow for the disposal includes a £45 million outflow to purchase a 9.99 per cent stake in China Life.

(iv) The acquisition of United Overseas Bank Life Assurance Limited (UOB) resulted in an outflow of cash from investing activities of £133 million. The remaining outflow of £12 million relates to the PAC with-profits fund purchase of Meterserve.

(v) Structural borrowings of shareholder-financed operations comprise core debt of the parent company, PruCap bank loan and Jackson surplus notes. Core debt excludes borrowings to support short-term fixed income securities programmes, non-recourse borrowings of investment subsidiaries of shareholder-financed operations and other borrowings of shareholder-financed operations. Cash flows in respect of these borrowings are included within cash flows from operating activities.

(vi) Structural borrowings of with-profits operations relate solely to the £100 million 8.5 per cent undated subordinated guaranteed bonds which contribute to the solvency base of the Scottish Amicable Insurance Fund (SAIF), a ring-fenced sub-fund of the PAC with-profits fund. Cash flows in respect of other borrowings of with-profits funds, which principally relate to consolidated investment funds, are included within cash flows from operating activities.

(vii) Cash movements in respect of equity capital exclude scrip dividends.

## NOTES ON THE IFRS BASIS RESULTS

### A Basis of preparation and audit status

The statutory basis results included in this announcement have been extracted from the audited financial statements of the Group for the year ended 31 December 2010. These statements have been prepared in accordance with IFRS as issued by the International Accounting Standards Board (IASB) and as endorsed by the European Union (EU) as required by EU law (IAS Regulation EC1606/2032). EU-endorsed IFRSs may differ from IFRSs issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU. At 31 December 2010, there were no unendorsed standards effective for the two years ended 31 December 2010 affecting the consolidated financial information of the Group and there were no differences between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to the Group. The auditors have reported on the 2010 statutory accounts. The financial information set out in this announcement does not constitute the Company's statutory accounts for the years ended 31 December 2010 or 2009 but is derived from these accounts.

Statutory accounts for 2009 have been delivered to the registrar of companies, and those for 2010 will be delivered following the Company’s Annual General Meeting. The auditors have reported on these accounts. Their report was (i) unqualified, (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report and (iii) did not contain a statement under Section 498(2) or (3) of the Companies Act 2006.

The additional information shown in notes 1 to 8 is unaudited.

### B Significant accounting policies

The accounting policies applied by the Group in determining the IFRS basis results in this announcement are the same as those previously applied in the Group’s consolidated financial statements for the year ended 31 December 2009, except for the adoption of the new accounting pronouncements in 2010 as described below. In addition, the presentation of operating profit based on longer-term investment returns, as applied in the supplementary analysis of profit before shareholder tax and segment reporting, has been altered for the Group’s US insurance operations as described in note C.

**Revised IFRS 3, ‘Business Combinations’ and Amendments to IAS 27, ‘Consolidated and Separate Financial Statements’ and IAS 31, ‘Interests in Joint Ventures’**

The Group has applied the revised IFRS 3 and amended IAS 27 and IAS 31 from 1 January 2010. The revised IFRS 3 and amended IAS 27 and IAS 31 are the outcomes of the second phase of the IASB’s and the US Financial Accounting Standards Board’s (FASB) joint business combination project. The change in accounting policy as a result of the adoption of these standards has been applied prospectively. No restatement to 2009 comparatives is required. The more significant changes from the revised IFRS 3 include:

- the immediate expensing of acquisition-related costs rather than inclusion in goodwill;
- recognition and measurement at fair value of contingent consideration classified as financial instruments at acquisition date with subsequent changes to income; and.
- additional items or adjustments to items recognised in the business combination are permitted to be applied retrospectively during the measurement period to reflect new information obtained about facts and circumstances that existed as of the acquisition date. The measurement period ends as soon as the acquirer receives the necessary information or learns that more information is not obtainable but is subject to an overall limit for one year.

The amendments to IAS 27 reflect changes to the accounting for non-controlling interests (known as minority interests prior to the amendments). From 1 January 2010, transactions that increase or decrease non-controlling interests without a change of control are accounted as equity transactions and therefore no goodwill is recognised. As a consequence, any gains or losses are reported directly in equity and not in the income statement.

The amendments to IAS 31 reflect changes to the accounting for changes in joint control over an entity. From 1 January 2010, when a jointly controlled entity becomes an associate of an investor, the investor shall measure at fair value any investment the investor retains in the former jointly controlled entity. The investor shall recognise in profit or loss any difference between:

(a) the fair value of any retained investments and any proceeds from disposing of the part interests in the jointly controlled entity; and

(b) the carrying amount of an investment at the date when joint control is lost.

Previously, no explicit guidance was provided.

The adoption of revised IFRS 3 and amended IAS 27 and IAS 31 has resulted in presentational and disclosure changes in the Group’s financial statements, and affected the accounting for the acquisition of United Overseas Bank (UOB) Life Assurance Limited in Singapore. The disclosure on this acquisition is provided in note P. As a result of the adoption of the revised IFRS 3, the Group has expensed the UOB Life acquisition-related costs incurred of £2 million which would otherwise have been included within goodwill. The Group has also recognised a gain of £30 million related to the change of treatment of PruHealth from a joint venture to an associate, in line with the revisions to IAS 31 set out above as described in note H.

**Other accounting pronouncements adopted in 2010**

In addition, the Group has adopted the following accounting pronouncements in 2010 but their adoption has had no material impact on the results and financial position of the Group:

- Improvements to IFRSs (2009), which includes minor changes to 12 IFRSs;
- Amendments to IFRS 2, 'Group cash-settled share-based payment transactions'; and
- Amendments to IAS 39, 'Financial instruments: Recognition and measurement' – Eligible hedged items.

This is not intended to be a complete list of accounting pronouncements effective in 2010 as only those that could have an impact upon the Group's financial statements have been discussed.

## C Segment disclosure – income statement

| | 2010 £m | 2009 note (ii) £m |
|---|---|---|
| Asian operations (note (i)) | | |
| Insurance operations (note E(i)) | | |
| Underlying results before exceptional credit | **536** | 353 |
| Exceptional credit for Malaysia operations (note E(i)) | **-** | 63 |
| Total Asian insurance operations | **536** | 416 |
| Development expenses | **(4)** | (6) |
| **Total Asian insurance operations after development expenses** | **532** | 410 |
| **Asian asset management** | **72** | 55 |
| Total Asian operations | **604** | 465 |
| | | |
| US operations | | |
| **Jackson (US insurance operations)** (notes (ii) and E(ii)) | **833** | 618 |
| **Broker-dealer and asset management** | **22** | 4 |
| Total US operations | **855** | 622 |
| | | |
| UK operations | | |
| UK insurance operations: | | |
| Long-term business (note E(iii)) | **673** | 606 |
| General insurance commission (note (iii)) | **46** | 51 |
| **Total UK insurance operations** | **719** | 657 |
| **M&G** | **284** | 238 |
| Total UK operations | **1,003** | 895 |
| **Total segment profit** | **2,462** | 1,982 |
| | | |
| Other income and expenditure | | |
| Investment return and other income | **30** | 22 |
| Interest payable on core structural borrowings | **(257)** | (209) |
| Corporate expenditure | **(220)** | (203) |
| Charge for share-based payments for Prudential schemes (note (iv)) | **(3)** | (5) |
| Total | **(450)** | (395) |
| Solvency II implementation costs | **(45)** | - |
| Restructuring costs (note (v)) | **(26)** | (23) |
| **Operating profit based on longer-term investment returns** (note (ii)) | **1,941** | 1,564 |
| Short-term fluctuations in investment returns on shareholder-backed business (note F) | **(123)** | (123) |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes (note (vi)) | **(10)** | (74) |
| Costs of terminated AIA transaction (note G) | **(377)** | - |
| Gain on dilution of holding in PruHealth (note H) | **30** | - |
| Loss on sale and results for Taiwan agency business (notes (i) and J) | **-** | (621) |
| **Profit from continuing operations before tax attributable to shareholders** | **1,461** | 746 |

**Notes**

(i) Sale of Taiwan agency business: In order to facilitate comparisons of operating profit based on longer-term investment returns that reflect the Group's retained operations, the results attributable to the Taiwan business for which the sale process was completed in June 2009 are included separately within the segmental analysis of profit for 2009.

(ii) The Group has amended the presentation of operating profit for its US insurance operations to remove the net equity hedge accounting effect (incorporating related amortisation of deferred acquisition costs) and include it in short-term fluctuations. The 2009 comparatives have been amended accordingly. The effect of this change is explained below in this note.

(iii) UK operations transferred its general insurance business to Churchill in 2002, with general insurance commission representing the net commission receivable net of expenses for Prudential-branded general insurance products as part of this arrangement.

(iv) The charge for share-based payments for Prudential schemes is for the SAYE and Group performance-related schemes.

(v) Restructuring costs comprise amounts incurred in the UK business defined as covered for EEV reporting purposes of £26 million and as part of central operations (EEV non-covered business) of £nil (2009: £16 million and £7 million respectively).

(vi) The shareholders' share of actuarial and other gains and losses on defined benefit pension schemes reflects the aggregate of actual less expected returns on scheme assets, experience gains and losses, the effect of changes in assumptions and altered provisions for deficit funding, where relevant.

### Determining operating segments and performance measure of operating segments

The Group's operating segments determined in accordance with IFRS 8, are as follows:

Insurance operations

– Asia
– US (Jackson)
– UK

Asset management operations
– M&G
– Asian asset management
– US broker-dealer and asset management (including Curian)

Prudential Capital has been incorporated into the M&G operating segment for the purposes of segment reporting.

The performance measure of operating segments utilised by the Company is IFRS operating profit attributable to shareholders based on longer-term investment returns. This measure excludes the recurrent items of short-term fluctuations in investment returns and the shareholders' share of actuarial and other gains and losses on defined benefit pension schemes. In addition, for 2010 this measure excluded costs associated with the terminated AIA transaction and gain arising upon the dilution of the Group's holding in PruHealth. For 2009 it excluded the non-recurrent cost of hedging the Group IGD capital surplus included within short-term fluctuations in investment returns and the loss on sale and the results of the Taiwan agency business during the period of ownership. In 2010 the Company amended its presentation of operating profit for its US insurance operations to exclude the net equity hedging gains and losses previously included relating principally to its variable annuity business. These amounts are included in short-term fluctuations in investment returns. Prior year comparatives have been amended accordingly. There is no change to total profit for continuing operations before tax attributable to shareholders arising from this altered treatment. Operating earnings per share is based on operating profit based on longer-term investment returns, after tax and non-controlling interests.

Segments results that are reported to the Group Executive Committee (GEC) include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items are mainly in relation to the Group Head Office and Asian Regional Head Office.

For the purposes of measuring operating profit, investment returns on shareholder-financed business are based on the expected longer-term rates of return. This reflects the particular features of long-term insurance business where assets and liabilities are held for the long-term and for which the accounting basis for insurance liabilities under current IFRS is not generally conducive to demonstrating trends in underlying performance for life businesses exclusive of changes in market conditions. In determining profit on this basis, the following key elements are applied to the results of the Group's shareholder-financed operations.

*(a) Debt and equity securities*
Longer-term investment returns comprise income and longer-term capital returns. For debt securities the longer-term capital returns comprise two elements. These are a risk margin reserve (RMR) based charge for expected defaults, which is determined by reference to the credit quality of the portfolio, and amortisation of interest-related realised gains and losses to operating results based on longer-term investment returns to the date when sold bonds would have otherwise matured. The shareholder-backed operation for which the RMR charge is most significant is Jackson National Life.

For 2010 and 2009 Jackson has used the ratings resulting from the regulatory ratings detail issued by the National Association of Insurance Commissioners (NAIC) for residential mortgage-backed securities (RMBS) to determine the average annual RMR. In addition, in 2010, the NAIC extended the new ratings framework to that previously covered residential mortgage-backed securities (RMBS) to include, commercial mortgage-backed securities (CMBS), which Jackson has used for 2010. These were developed by external third parties; PIMCO (for RMBS) and BlackRock Solutions (for CMBS), and are considered by management more relevant information for the MBS securities concerned than using ratings by Nationally Recognised Statistical Ratings Organisations (NRSRO).

*(b) US variable and fixed index annuity business*
*(i) <u>Current treatment</u>*
The following value movements for Jackson's variable and fixed index annuity business are excluded from operating profit based on longer-term investment returns:

- Fair value movements for equity-based derivatives;
- Fair value movements for embedded derivatives for Guaranteed Minimum Withdrawal Benefit (GMWB) "not for life" and fixed index annuity business, and Guaranteed Minimum Income Benefit (GMIB) reinsurance;
- Movements in accounts carrying value of GMDB and GMWB "for life" liabilities;
- Fee assessment, and claim payments, in respect of guarantee liabilities; and
- Related changes to amortisation of deferred acquisition costs for each of the above items.

*(ii) <u>Change of treatment in 2010</u>*
For previous reporting of the 2009 results, all of the above items were included in operating profit based on longer-term investment returns with the intention of broadly matching the impacts with two exceptions. The exceptions were for the effect of GMIB reinsurance and movements in carrying values of free standing derivatives and embedded derivatives arising from changes in the level of observed implied equity volatility and changes in the discount rate applied from year to year. Both of these items remain in short-term fluctuations in investment returns in 2010.

Previously, for the purposes of determining operating profit based on longer-term investment returns, the charge for these features was determined using historical longer-term equity volatility levels and long-term average AA corporate bond rate curves with the movement relating to the change in difference in longer-term and current rates being included in short-term fluctuations (as shown in note F (e)).

However, despite this use of longer-term equity volatility assumption levels and AA corporate bond rate curves, accounting volatility arose within the operating profit based on longer-term investment returns that was not representative of the underlying economic result. This feature arose due to the movement in the change in the accounting values of the derivatives and Jackson's liabilities for variable and fixed indexed annuity guarantees included in the operating profit. Under IFRS, liabilities for GMDB and 'for life' GMWB are not fair valued. Instead, they are accounted for under IFRS using 'grandfathered' US GAAP in accordance with FASB ASC Subtopic 944-80, Financial Services – Insurance – Separate Accounts (formerly SOP 03-1). This accounting basis produces a distorting accounting effect on the operating profit that is not representative of the true economics of Jackson's hedging programme. Over the long term the impact of this accounting distortion should cumulatively net out to a broadly neutral effect, but in the short term the operating profit can be highly volatile. The recent growth in Jackson's variable annuity business had resulted in this short-term effect having a greater impact on the Group operating profit than in prior years. Further, these accounting mismatches are magnified in periods of significant market movements. These factors have prompted a reassessment of the presentation of operating profit based on longer-term investment returns.

The following items have been reclassified from operating profit to short-term fluctuations in investment returns:

- The fair value movement in free standing hedging derivatives, excluding the impact of the difference between longer-term and current period implied equity volatility levels;
- The movement in liabilities for those embedded derivative liabilities which are fair valued in accordance with IFRS, primarily GMWB "not for life" and fixed index annuity business, excluding the impacts of the differences between longer-term and current period equity volatility and incorporating 10-year average yield curves, in lieu of current period yield curves;
- Movements in IFRS basis guarantee liabilities for GMWB "for life", being those policies where a minimum annual withdrawal is permitted for the duration of the policyholders life subject to certain conditions, and GMDB business for which, under the US GAAP rules applied under IFRS, the reserving methodology under US GAAP principles generally gives rise to a muted impact of current period market movements;
- Fee assessment, and claims payments, in respect of guarantee liabilities;
- Related changes to the amortisation of deferred acquisition costs for each of the above items.

The change reflects management's IFRS 8 segment measure. Within the supplementary analysis of profit, the change is presentational only. It has no impact on profit before tax or shareholders' equity. The impact of this change is as follows:

| | **2010** | | | 2009 | | |
|---|---|---|---|---|---|---|
| | **Previous basis** | **Change** | **Revised basis** | Previous basis | Change | Revised basis |
| | £m | £m | £m | £m | £m | £m |
| Operating profit based on longer-term investment returns | | | | | | |
| Jackson | **466** | **367** | **833** | 459 | 159 | 618 |
| Rest of Group | **1,108** | – | **1,108** | 946 | – | 946 |
| Total | **1,574** | **367** | **1,941** | 1,405 | 159 | 1,564 |
| Short-term fluctuations in investment returns on shareholder-backed business | **244** | **(367)** | **(123)** | 36 | (159) | (123) |
| Shareholders' share of actuarial and other gains and loss on defined benefit pension schemes | **(10)** | – | **(10)** | (74) | – | (74) |
| Costs of terminated AIA transaction | **(377)** | – | **(377)** | – | – | – |
| Gain on dilution of holding in PruHealth | **30** | – | **30** | – | – | – |
| Loss on sale and results of Taiwan agency business | – | – | – | (621) | – | (621) |
| Profit from continuing operations before tax attributable to shareholders | **1,461** | – | **1,461** | 746 | – | 746 |

*(iii)* US operations – Embedded derivatives for variable annuity guarantee features

The Guaranteed Minimum Income Benefit (GMIB) liability, which is fully reinsured, subject to a deductible and annual claim limits, is accounted for in accordance with FASB ASC Subtopic 944-80 Financial Services – Insurance – Separate Accounts(formerly SOP 03-1) under IFRS using 'grandfathered' US GAAP. As the corresponding reinsurance asset is net settled, it is considered to be a derivative under IAS 39 and the asset is therefore recognised at fair value. As the GMIB benefit is economically reinsured the mark to market element of the reinsurance asset is included as a component of short-term fluctuations in investment returns.

*(c) Other derivative value movements*
Derivative value movements are excluded from operating results based on longer-term investment returns. Non-equity based derivatives are primarily held by Jackson as part of a broadly-based hedging programme for features of Jackson's bond portfolio (for which value movements are booked in the statement of comprehensive income rather than the income statement) and product liabilities (for which US GAAP accounting as grandfathered under IFRS 4 does not reflect the economic features being hedged).

Value movements for Jackson's equity-based derivatives and variable and fixed index annuity product embedded derivatives were in prior periods included in operating profits based on longer-term investment returns. In 2010 these value movements, which are variable in nature, have been included in short-term fluctuations and 2009 comparatives have been adjusted accordingly.

There are two exceptions to the basis described above in sections (a) to (c) for determining operating results based on longer-term investment returns. These are for:

– Unit-linked and US variable annuity business. For such business the policyholder unit liabilities are directly reflective of the asset value movements. Accordingly all asset value movements are recorded in the operating results based on longer-term investment returns.

– Assets covering non participating business liabilities that are interest rate sensitive. For UK annuity business policyholder liabilities are determined by reference to current interest rates. The value movements of the assets covering liabilities are closely correlated with the related change in liabilities. Accordingly asset value movements are recorded within the operating results based on longer-term investment returns. Policyholder liabilities include a margin for credit risk. Variations between actual and best estimate expected impairments are recorded as a component of short-term fluctuations in investment returns.

*(d) Other liabilities to policyholders and embedded derivatives for product guarantees*
Under IFRS, the degree to which the carrying values of liabilities to policyholders are sensitive to current market conditions varies between territories depending upon the nature of the 'grandfathered' measurement basis. In general, in those instances where the liabilities are particularly sensitive to routine changes in market conditions, the accounting basis is such that the impact of market movements on the assets and liabilities is broadly equivalent in the income statement, and operating profit based on longer-term investments returns is not distorted. In these circumstances, there is no need for the movement in the liability to be bifurcated between the elements that relate to longer-term market conditions and short-term effects.

However, some types of business movements in liabilities do require bifurcation to ensure that at the net level (i.e. after allocated investment return and change for policyholder benefits) the operating result reflects longer-term market returns.

Examples where such bifurcation is necessary are:

(i) Asia

- *Vietnamese participating business*

For the participating business in Vietnam the liabilities include policyholders' interest in investment appreciation and other surplus. Bonuses paid in a reporting period and accrued policyholders' interest in investment appreciation and other surpluses primarily reflect the level of realised investment gains above contract specific hurdle levels. For this business, operating profit based on longer-term investment returns includes the aggregate of longer-term returns on the relevant investments, a credit or charge equal to movements on the liability for the policyholders' interest in realised investment gains (net of any recovery of prior deficits on the participating pool), less amortisation over five years of current and prior movements on such credits or charges.

The overall purpose of these adjustments is to ensure that investment returns included in operating results equal longer-term returns but that in any one reporting period movements on liabilities to policyholders caused by investment returns are substantially matched in the presentation of the supplementary analysis of profit before tax attributable to policyholders.

- *Non-participating business*

Bifurcation for the effect of determining the movement in the carrying value of liabilities to be included in operating results based on longer-term investment returns, and the residual element for the effect of using year end rates is included in short-term fluctuations and in the income statement.

- *Guaranteed Minimum Death Benefit (GMDB) product features*

For unhedged GMDB liabilities accounted for under IFRS using 'grandfathered' US GAAP, such as in the Japanese business, the change in carrying value is determined under FASB ASC subtopic 944-80, Financial Services – Insurance – Separate Accounts (formerly SOP 03-1), which partially reflects changes in market conditions. Under the company's segmental basis of reporting the operating profit reflects the change in liability based on longer-term market conditions with the difference between the charge to the operating result and the movement reflected in the total result included in short-term fluctuations in investment returns.

(ii) UK shareholder-backed annuity business
With one exception, the operating result based on longer-term investment returns reflects the impact of all value movements on policyholder liabilities for annuity business in PRIL and the PAC non-profit sub-fund.

The exception is for the impact on credit risk provisioning of actual downgrades during the period. As this feature arises due to short-term market conditions, the effect of downgrades, if any, in a particular period, on the overall provisions for credit risk is included in the category of short-term fluctuations in investment returns.

The effects of other changes to credit risk provisioning are included in the operating result, as is the net effect of changes to the valuation rate of interest due to portfolio rebalancing to align more closely with management benchmark.

*(e) Fund management and other non-insurance businesses*
For these businesses, the particular features applicable for life assurance noted above do not apply. For these businesses it is inappropriate to include returns in the operating result on the basis described above. Instead, it is appropriate to generally include realised gains and losses (including impairments) in the operating result with unrealised gains and losses being included in short-term fluctuations. For this purpose impairments are calculated as the credit loss determined by comparing the projected cash flows discounted at the original effective interest rate to the carrying value. In some instances it may also be appropriate to amortise realised gains and losses on derivatives and other financial instruments to operating results over a time period that reflects the underlying economic substance of the arrangements.

**Additional segmental analysis of revenue**
The additional segmental analyses of revenue from external customers excluding investment return and net of outward reinsurance premiums are as follows:

| | **2010** | | | | |
|---|---|---|---|---|---|
| | **Asia** | **US** | **UK** | **Intragroup** | **Total** |
| | £m | £m | £m | £m | £m |
| Revenue from external customers: | | | | | |
| Insurance operations | **6,373** | **11,710** | **6,476** | **(10)** | **24,549** |
| Asset management | **248** | **597** | **768** | **(314)** | **1,299** |
| Unallocated corporate | **-** | **-** | **29** | **-** | **29** |
| Intragroup revenue eliminated on consolidation | **(77)** | **(72)** | **(175)** | **324** | **-** |
| Total revenue from external customers | **6,544** | **12,235** | **7,098** | **-** | **25,877** |

| | 2009 | | | | |
|---|---|---|---|---|---|
| | Asia | US | UK | Intragroup | Total |
| | £m | £m | £m | £m | £m |
| Revenue from external customers: | | | | | |
| Insurance operations | 5,336 | 9,097 | 5,822 | (11) | 20,244 |
| Asset management | 213 | 499 | 513 | (271) | 954 |
| Unallocated corporate | - | - | 12 | - | 12 |
| Intragroup revenue eliminated on consolidation | (70) | (67) | (145) | 282 | - |
| Total revenue from external customers | 5,479 | 9,529 | 6,202 | - | 21,210 |

Revenue from external customers is made up of the following:

| | **2010** | 2009 |
|---|---|---|
| | £m | £m |
| Earned premiums, net of reinsurance | **24,211** | 19,976 |
| Fee income from investment contract business and asset management (included within 'Other income') | **1,666** | 1,234 |
| Total revenue from external customers | **25,877** | 21,210 |

In their capacity as fund managers to fellow Prudential Group subsidiaries, M&G, the US and the Asian asset management businesses generate fees for investment management and related services. Intragroup fees included within asset management revenue were £314 million (2009: £271 million) earned £165 million (2009: £134 million) by M&G, £72 million (2009: £67 million) by the US asset management segment and £77 million (2009: £70 million) by the Asian asset management segment. In 2010, the remaining £10 million (2009: £11 million) of intragroup revenue was recognised by UK insurance operations. These services are typically charged as a percentage of funds under management.

Revenue from external customers of Asian, US and UK insurance operations shown above are net of outwards reinsurance premiums of £146 million, £83 million, and £128 million respectively (2009: £119 million, £82 million and £122 million respectively).

## D Profit before tax – Asset management operations

The profit included in the income statement in respect of asset management operations is as follows:

| | M&G | US | Asia (note(v)) | Total 2010 | Total 2009 |
|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m |
| Revenue, (excluding revenue of consolidated investment funds and NPH broker-dealer fees) | **943** | **229** | **251** | **1,423** | 1,097 |
| Revenue of consolidated investment funds(note (i)) | **11** | **-** | **-** | **11** | 102 |
| NPH broker-dealer fees(note (ii)) | **-** | **369** | **-** | **369** | 317 |
| Gross revenue | **954** | **598** | **251** | **1,803** | 1,516 |
| Charges, (excluding charges of consolidated investment funds and NPH broker-dealer fees) | **(617)** | **(207)** | **(179)** | **(1,003)** | (744) |
| Charges of consolidated investment funds(note (i)) | **(11)** | **-** | **-** | **(11)** | (102) |
| NPH broker-dealer fees(note (ii)) | **-** | **(369)** | **-** | **(369)** | (317) |
| Gross charges | **(628)** | **(576)** | **(179)** | **(1,383)** | (1,163) |
| **Profit before tax** | **326** | **22** | **72** | **420** | 353 |
| Comprising: | | | | | |
| Operating profit based on longer-term investment returns(note (iii)) | **284** | **22** | **72** | **378** | 297 |
| Short-term fluctuations in investment returns (note (iv)) | **47** | **-** | **-** | **47** | 70 |
| Shareholder's share of actuarial gains and losses on defined benefit pension schemes | **(5)** | **-** | **-** | **(5)** | (14) |
| **Profit before tax** | **326** | **22** | **72** | **420** | 353 |

**Notes**

(i) Revenue in respect of consolidated investment funds. The investment funds are managed on behalf of third-parties and are consolidated under IFRS in recognition of the control arrangements for the funds. The gains (losses) in respect of the investment funds are non-recourse to M&G and the Group and are added back through charges and consequently there is no impact on the profit before tax.

(ii) NPH broker-dealer fees represents commissions received, which are then paid on to the writing broker on sales of investment products.

(iii) M&G operating profit based on longer-term investment returns:

| | 2010 | 2009 |
|---|---|---|
| | £m | £m |
| Asset management fee income | **612** | 457 |
| Other income | **3** | 13 |
| Staff costs | **(263)** | (205) |
| Other costs | **(123)** | (100) |
| Underlying profit before performance-related fees | **229** | 165 |
| Performance-related fees | **17** | 12 |
| Operating profit from asset management operations | **246** | 177 |
| Operating profit from Prudential Capital | **38** | 61 |
| Total M&G operating profit based on longer-term investment returns | **284** | 238 |

The difference between the fees and other income shown above in respect of asset management operations, and the revenue figure for M&G shown (excluding consolidated investment funds) in the main table primarily relates to total revenue of Prudential Capital (including short-term fluctuations) of £136 million (2009: £155 million) and commissions which have been netted off in arriving at the fee income of £612 million (2009: £457 million) in the table above. The difference in the presentation of commission is aligned with how management reviews the business.

(iv) Short-term fluctuations in investment returns for M&G are primarily in respect of unrealised value movements on Prudential Capital's bond portfolio.

(v) Included within Asian asset management revenue and charges are £60 million of commissions (2009:£57 million).

## E Key assumptions, estimates and bases used to measure insurance assets and liabilities

**(i)** Asian insurance operations

*(a)* In 2010, one-off changes made to reserving assumptions resulted in a release from liabilities of £19 million.

*(b)* In 2009, the local regulatory basis in Malaysia was replaced by the Malaysian authority's Risk-Based Capital (RBC) framework. In light of this development, the Company re-measured these liabilities by reference to the method applied under the new RBC framework which resulted in a one-off release from liabilities at 1 January 2009 of £63 million.

**(ii)** US insurance operations

There are no changes in assumptions that had a material impact on the 2010 results of US insurance operations.

Separately, in 2010, the Group amended its presentation of operating profit for its US insurance operations to exclude the net equity hedge accounting effect of negative £367 million (2009: negative £159 million) relating to its variable and fixed index annuity business and reclassified it as a short-term fluctuation within the Group's supplementary analysis of profit. This is explained further in note C(b). This change had no effect on the measurement of insurance assets and liabilities and therefore on total profit or shareholders' equity.

**(iii)** UK insurance operations

*Annuity business: allowance for credit risk*

For IFRS reporting, the results for UK shareholder-backed annuity business are particularly sensitive to the allowances made for credit risk. The allowance is reflected in the deduction from the valuation rate of interest for discounting projected future annuity payments to policyholders that would have otherwise applied. Since mid-2007 there has been a significant increase in the actual and perceived credit risk associated with corporate bonds as reflected in the significant widening that has occurred in corporate bond spreads. Although bond spreads over swap rates have narrowed from their peak in March 2009, they are still high compared with the levels seen in the years immediately preceding the start of the dislocated markets in 2007. The allowance that should therefore be made for credit risk remains a particular area of judgement.

The additional yield received on corporate bonds relative to swaps can be broken into the following constituent parts:

(a) the expected level of future defaults;
(b) the credit risk premium that is required to compensate for the potential volatility in default levels;
(c) the liquidity premium that is required to compensate for the lower liquidity of corporate bonds relative to swaps; and
(d) the mark to market risk premium that is required to compensate for the potential volatility in corporate bond spreads (and hence market values) at the time of sale.

The sum of (c) and (d) is often referred to as "liquidity premium".

The credit risk allowance is a function of the asset mix and the credit quality of the underlying portfolio. At 31 December 2010, 84 per cent (2009: 80 per cent) of the assets backing the UK shareholder annuity and other business were debt securities as shown in O (i). This comprises both government and corporate bonds. Government bonds are generally given a credit default allowance of zero. For corporate bonds the credit allowance varies by credit rating. An analysis of the credit ratings of debt securities is included in note U (i).

Given that the normal business model for Prudential's annuity business is to hold bonds to match long-term liabilities, the valuation rate that is applied to discount the future annuity payments includes a liquidity premium that reflects the residual element of current bond spreads over swap rates after providing for the credit risk.

Historically, until the second half of 2007, when corporate bond spreads widened significantly, the allowance for credit risk was calculated as the long-term expected defaults and a long-term credit risk premium. This long-term credit risk was supplemented by a short-term allowance from 31 December 2007 to allow for the concern that credit ratings applied by the rating agencies may be downgraded and defaults in the short-term might be higher than the long-term assumptions.

The weighted components of the bond spread over swap rates for shareholder-backed fixed and linked annuity business for PRIL at 31 December 2010, 2009 and 2008, based on the asset mix at the relevant balance sheet date are shown below.

| 31 December 2010 | Pillar 1 regulatory basis (bps) | Adjustment from regulatory to IFRS basis (bps) | IFRS (bps) |
|---|---|---|---|
| Bond spread over swap rates (note (i)) | **160** | **-** | **160** |
| Long-term expected defaults (note (ii)) | **16** | **-** | **16** |
| Long-term credit risk premium (note (iii)) | **10** | **-** | **10** |
| Short-term allowance for credit risk (note (iv)) | **42** | **(26)** | **16** |
| Total credit risk allowance | **68** | **(26)** | **42** |
| Liquidity premium | **92** | **26** | **118** |

| 31 December 2009 | Pillar 1 regulatory basis (bps) | Adjustment from regulatory to IFRS basis (bps) | IFRS (bps) |
|---|---|---|---|
| Bond spread over swap rates (note (i)) | 175 | - | 175 |
| Credit risk allowance | | | |
| Long-term expected defaults (note (ii)) | 19 | - | 19 |
| Long-term credit risk premium (note (iii)) | 13 | - | 13 |
| Short-term allowance for credit risk (note (iv)) | 39 | (24) | 15 |
| Total credit risk allowance | 71 | (24) | 47 |
| Liquidity premium | 104 | 24 | 128 |

| 31 December 2008 | Pillar 1 regulatory basis (bps) | Adjustment from regulatory to IFRS basis (bps) | IFRS (bps) |
|---|---|---|---|
| Bond spread over swap rates (note (i)) | 323 | - | 323 |
| Credit risk allowance | | | |
| Long-term expected defaults (note (ii)) | 15 | - | 15 |
| Long-term credit risk premium (note (iii)) | 11 | - | 11 |
| Short-term allowance for credit risk (note (iv)) | 54 | (25) | 29 |
| Total credit risk allowance | 80 | (25) | 55 |
| Liquidity premium | 243 | 25 | 268 |

**Notes**

(i) Bond spread over swap rates reflect market observed data.

(ii) For the valuations prior to 31 December 2010, long-term expected defaults were derived by applying Moody's data from 1970 to 2004 uplifted by between 100 per cent (B) and 200 per cent (AAA) according to credit rating on the annuity asset portfolio. The credit rating assigned to each asset held was based on external credit rating and for this purpose the credit rating assigned to each asset held was the lowest credit rating published by Moody's, Standard and Poors and Fitch.
For the 31 December 2010 valuation, long-term expected defaults are derived by applying Moody's data from 1970 to 2009 and the definition of the credit rating used has been revised from the lowest credit rating to the second highest credit rating published by Moody's, Standard and Poors and Fitch.

(iii) For the valuations prior to 31 December 2010, the long-term credit risk premium provides compensation against the risk of potential volatility in the level of defaults and is derived by applying the 95th percentile from Moody's data from 1970 to 2004 to the annuity asset portfolio. For the 31 December 2010 valuation, the long-term credit risk premium is derived from Moody's data from 1970 to 2009.
The combined effect of this change and the changes described in (ii) above is neutral on the long-term credit risk allowance for PRIL.

(iv) The short-term allowance for credit risk assumed in the Pillar 1 solvency valuations at 31 December 2008 was determined as 25 per cent of the increase in corporate bond spreads (as estimated from the movements in published corporate bond indices) since 31 December 2006. Subsequent to this date movements have reflected events in the period, namely the impact of credit migration, the decision not to release favourable default experience, new business and asset trading amongst other items. This is demonstrated by the analyses below.

The very prudent Pillar 1 regulatory basis reflects the overriding objective of ensuring sufficient provisions and capital to ensure payments to policyholders can be made. The approach for IFRS aims to establish liabilities that are closer to 'best estimate'. IFRS default assumptions are therefore set between the EEV and Pillar I assumptions.

*Factors affecting the credit risk allowance at 31 December 2010*

The main factors influencing the credit risk allowance at 31 December 2010 for PRIL are as follows:

*a Credit downgrades and default experience*

The credit risk allowances have been adjusted during 2010 to take account of emerging downgrade and default experience. Experience in relation to changes in credit rating has improved in 2010 and no assets defaulted for the PRIL business during the year. The allowance for short-term downgrades has been reduced to offset the impact of credit downgrades on the long-term assumptions. In addition, the allowance for short-term defaults has been updated to eliminate any experience profits that would otherwise have arisen due to default experience being better than allowed for in the opening reserves.

*b Asset trading*

Since the second half of 2009, the Group started trading out of subordinated financial debt into higher quality assets. The continuation of the reduction in the subordinated financial debt holdings in 2010 improved the overall credit quality of the corporate bond portfolio and so allowed a release of long-term credit reserves.

On a Pillar 1 basis this transaction had no overall impact on the solvency surplus of PRIL, the PAC non-participating sub-fund and PAL. On an IFRS basis, the reduction in subordinated financial debt holdings generated a pre-tax IFRS operating loss of £4 million (2009: loss of £51 million).

*c Asset purchases in respect of new business*

Similar to 2009, the assets purchased during 2010 to back new business have been of better average credit quality than the assets held at 31 December 2008, in particular no subordinated bank debt or sub-investment grade assets have been bought to back new business. As a result of the lower credit risk of the new business assets the overall allowance for credit risk required at 31 December 2010 is reduced when the new business assets and in-force assets are aggregated together.

After taking account of the factors noted above the movement on the average basis points allowance for PRIL on Pillar 1 regulatory and IFRS bases are as follows:

| | Pillar 1 Regulatory basis (bps) | | | IFRS (bps) | | |
|---|---|---|---|---|---|---|
| | Long term | Short term | Total | Long term | Short term | Total |
| Total allowance for credit risk at 31 December 2009 | **32** | **39** | **71** | **32** | **15** | **47** |
| Credit downgrades | **1** | **(1)** | **-** | **1** | **(1)** | **-** |
| Retention of surplus from favourable default experience | **-** | **7** | **7** | **-** | **3** | **3** |
| Asset trading | **(5)** | **-** | **(5)** | **(5)** | **-** | **(5)** |
| New business | **-** | **(2)** | **(2)** | **-** | **(1)** | **(1)** |
| Other | **(2)** | **(1)** | **(3)** | **(2)** | **-** | **(2)** |
| **Total allowance for credit risk at 31 December 2010** | **26** | **42** | **68** | **26** | **16** | **42** |

Overall this has led to a credit allowance for Pillar 1 purposes to be 43 per cent (2009: 41 per cent) of the bond spread over swap rates. For IFRS purposes it represents 26 per cent (2009: 27 per cent) of the bond spread over swap rates.

The reserves for credit risk allowance at 31 December 2010 for the UK shareholder annuity fund were as follows:

| | Pillar 1 Regulatory basis | | | IFRS | | |
|---|---|---|---|---|---|---|
| | Long term £bn | Short term £bn | Total £bn | Long term £bn | Short term £bn | Total £bn |
| PRIL | **0.6** | **1.0** | **1.6** | **0.6** | **0.4** | **1.0** |
| PAC non-profit sub-fund | **0.1** | **0.1** | **0.2** | **0.1** | **-** | **0.1** |
| Total | **0.7** | **1.1** | **1.8** | **0.7** | **0.4** | **1.1** |

*Mortality and other assumption changes*

In 2009, Prudential's annuity business liabilities were determined using the Continuous Mortality Investigation ("CMI") medium cohort projections with a floor. In November 2009 a new mortality projection model was released by the CMI. This model is expected to become the new industry standard.

The new model has been applied in determining the 2010 results with calibration to reflect an appropriate view of future mortality improvement. In recognition of the trend in assumed mortality improvements the Company has in previous years included margins in its annuity liabilities. In determining the 2010 results the appropriate level of these margins has been reassessed.

The net effect of applying the new model, releases of margins, and changes to other related mortality assumption for shareholder-backed business is a credit of £8 million. With a £38 million benefit from altered expense assumptions the overall credit for shareholder-backed business is £46 million.

## F Short-term fluctuations in investment returns on shareholder-backed business

| | 2010 £m | 2009* £m |
|---|---|---|
| Insurance operations: | | |
| Asia (note (ii)) | **114** | 31 |
| US (note (iii)) | **(378)** | (132) |
| UK (notes (i) and (iv)) | **116** | 108 |
| Other operations | | |
| – IGD hedge costs (note (v)) | **-** | (235) |
| – Other (note (vi)) | **25** | 105 |
| | **25** | (130) |
| Total | **(123)** | (123) |

*The Group has amended the presentation of operating profit for its US insurance operations to remove the net equity hedge accounting effect (incorporating related amortisation costs) and include it in short-term fluctuations. The 2009 comparatives have been amended accordingly. Note C explains the effect of the change.

**Notes**

(i) *General overview of defaults*
The Group incurred defaults of £nil in 2010 (2009: £11 million) on its debt securities portfolio. The defaults of £11 million in 2009 were experienced by the UK shareholder-backed annuity business.

(ii) *Asian insurance operations*
The fluctuations for Asian insurance operations in 2010 of £114 million primarily reflect unrealised gains on the debt securities held by shareholders' funds, as well as a £30 million unrealised gain on the Group's 8.66 per cent stake in China Life Insurance Company of Taiwan. For 2009, the gain of £31 million primarily relates to strong market performance in Taiwan and Japan partially offset by the fall in the Vietnamese bond markets.

(iii) *US insurance operations*
The short-term fluctuations in investment returns for US insurance operations comprise the following items:

| | 2010 £m | 2009* £m |
|---|---|---|
| Short-term fluctuations relating to debt securities: | | |
| Charges in the year (note (a)) | | |
| Defaults | **-** | - |
| Losses on sales of impaired and deteriorating bonds | **(99)** | (6) |
| Bond write downs | **(124)** | (630) |
| Recoveries / reversals | **10** | 5 |
| Total charges in the year (note (a)) | **(213)** | (631) |
| Less: Risk margin charge included in operating profit based on longer-term investment returns (note (b)) | **73** | 76 |
| | **(140)** | (555) |
| Interest related realised gains (losses): | | |
| Arising in the year | **224** | 125 |
| Less: Amortisation of gains and losses arising in current and prior years to operating profit based on longer-term investment returns | **(82)** | (59) |
| | **142** | 66 |
| Related change to amortisation of deferred acquisition costs | **(3)** | 75 |
| Total short-term fluctuations related to debt securities | **(1)** | (414) |
| Derivatives (other than equity related): market value movement (net of related change to amortisation of deferred acquisition costs) (note (c)) | **(15)** | 385 |
| Net equity hedge results based on longer-term equity volatility and interest rates (net of related change to amortisation of deferred acquisition costs) (note (d)) | **(367)** | (159) |
| Equity-related derivatives: volatility and interest rate normalisation (net of related change to amortisation of deferred acquisition costs) (note (e)) | **2** | 85 |
| Equity type investments: actual less longer-term return (net of related change to amortisation of deferred acquisition costs) (note (b)) | **3** | (59) |
| Other items (net of related change to amortisation of deferred acquisition costs) | **-** | 30 |
| Total | **(378)** | (132) |

*The Group has amended the presentation of operating profit for its US insurance operations to remove the net equity hedge accounting effect (incorporating related amortisation of deferred acquisition costs) and include it in short-term fluctuations. The 2009 comparatives have been amended accordingly. Note C explains the effect of the change.

**Notes**

(a) The charges on the debt securities of Jackson comprise the following:

| | **Defaults** £m | **Bond write downs** £m | **Losses on sale of impaired and deteriorating bonds** £m | **Recoveries/ reversals** £m | **Total 2010** £m | Total 2009 £m |
|---|---|---|---|---|---|---|
| Residential mortgage-backed securities: | | | | | | |
| Prime (including agency) | **-** | **21** | **35** | **-** | **56** | 268 |
| Alt-A | **-** | **35** | **20** | **(1)** | **54** | 182 |
| Sub-prime | **-** | **15** | **(2)** | **-** | **13** | 49 |
| Total residential mortgage-backed securities | **-** | **71** | **53** | **(1)** | **123** | 499 |
| Corporate debt securities | **-** | **1** | **40** | **(4)** | **37** | 107 |
| Other | **-** | **52** | **6** | **(5)** | **53** | 25 |
| Total | **-** | **124** | **99** | **(10)** | **213** | 631 |

Within other bond write downs of £52 million (2009: £30 million), £40 million (2009: £30 million) relates to Piedmont securities. Piedmont is an investment vehicle investing in certain asset-backed and mortgage-backed securities in the US.

(b) The risk margin reserve (RMR) charge for longer-term credit related losses included in operating profit based on longer-term investment returns for 2010 is based on an average annual RMR of 26 basis points (2009: 27 basis points) on average book values of US$44.2 billion (2009: US$ 43.9 billion) as shown below:

| **Moody's rating category (or equivalent under NAIC ratings of MBS)** | **2010** Average book value US$m | RMR % | Annual expected loss US$m | Annual expected loss £m | 2009 Average book value US$m | RMR % | Annual expected loss US$m | Annual expected loss £m |
|---|---|---|---|---|---|---|---|---|
| A3 or higher | **20,622** | **0.06** | **(12)** | **(8)** | 19,509 | 0.03 | (5) | (3) |
| Baa1, 2 or 3 | **20,785** | **0.26** | **(53)** | **(34)** | 21,072 | 0.23 | (47) | (30) |
| Ba1, 2 or 3 | **1,935** | **1.04** | **(20)** | **(13)** | 2,035 | 1.13 | (23) | (15) |
| B1, 2 or 3 | **500** | **2.99** | **(15)** | **(10)** | 594 | 2.86 | (17) | (11) |
| Below B3 | **321** | **3.88** | **(13)** | **(8)** | 691 | 3.91 | (27) | (17) |
| Total | **44,163** | **0.26** | **(113)** | **(73)** | 43,901 | 0.27 | (119) | (76) |
| Related change to amortisation of deferred acquisition costs (see below) | | | **28** | **18** | | | 25 | 16 |
| Risk margin reserve charge to operating profit for longer-term credit related losses | | | **(85)** | **(55)** | | | (94) | (60) |

For the period ended 31 December 2010, Jackson has continued the practice commenced in the second half of 2009 in relation to RMBS and for 2010 for CMBS to determine the risk margin charge included in operating profit based on longer-term investment returns using the regulatory rating as determined by external third parties; PIMCO (for RMBS) and BlackRock Solutions (for CMBS) on behalf of the National Association of Insurance Commissioners (NAIC). See note C for further information.

The longer-term rates of return for equity-type investments are currently based on spreads over 10 year US treasury rates of 400 to 600 basis points. The longer-term rates of return for equity-type investments ranged from 6.5 per cent to 7.9 per cent in 2010, and 6.7 per cent to 9.9 per cent in 2009 depending on the type of investments.

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

(c) The loss of £15 million (2009: gain of £385 million) is for the value movement of non-equity freestanding derivatives held to manage the fixed annuity and other general account business. Under IAS 39, unless hedge accounting is applied value movements on derivatives are recognised in the income statement.

For the derivatives programme attaching to the fixed annuity and other general account business the Group has continued its approach of not seeking to apply hedge accounting under IAS 39. This decision reflects the inherent constraints of IAS 39 for hedge accounting investments and life assurance assets and liabilities under 'grandfathered' US GAAP under IFRS 4.

(d) The Group has amended its presentation of equity-based derivatives and associated guarantee liabilities to remove the net equity hedge accounting effect (incorporating related amortisation of deferred acquisition costs) from operating profit based on longer-term investment returns and include it in short-term fluctuations. The 2009 comparatives have been amended accordingly. The effect of this change is explained in note C.

(e) Prior to the change in the presentation of operating profit of the US insurance operations as explained in note C, the effect of the difference in the value movements for freestanding derivatives and embedded derivatives arising from changes between longer-term and actual levels of implied equity volatility and end of period AA corporate bond yield curves was reflected in short-term fluctuations in investment return. This normalisation reflects the use of longer-term implied equity volatility levels, and also, for embedded derivatives 10 year average AA corporate bond yield curves, in the value movement included in net equity hedge accounting effect and is unaffected by the change in the presentation of the net equity hedge accounting effect.

This volatility and interest rate normalisation of value movements for freestanding and embedded derivatives gave rise to a £2 million gain (2009: £85 million). The net equity hedge accounting effect based on longer-term equity volatility and interest rate is as described above in note (d).

(f) In addition to the items discussed above, for US insurance operations, included within the statement of comprehensive income is an increase in net unrealised gains on debt securities classified as available-for-sale of £1,221 million (2009: reduction in net unrealised losses of £2,669 million). Temporary market value movements do not reflect defaults or impairments. Additional details on the movement in the value of the Jackson portfolio are included in note V.

(iv) *UK insurance operations*

The short-term fluctuations gain for UK insurance operations of £116 million (2009: £108 million) reflected principally asset value movements for shareholder-backed annuity business.

(v) *IGD hedge costs*

During the severe equity market conditions experienced in the first quarter of 2009 coupled with historically high equity volatility, the Group entered into exceptional short-dated hedging contracts to protect against potential tail-events on the IGD capital position, in addition to the regular operational hedging programmes. The hedge contracts have expired and have not been renewed.

(vi) *Other*

Short-term fluctuations of other operations, in addition to the previously discussed IGD hedge costs, arise from:

| | **2010** £m | 2009 £m |
|---|---|---|
| Unrealised value movements on swaps held centrally to manage Group assets and liabilities | **(25)** | 28 |
| Unrealised value movements on Prudential Capital bond portfolio | **48** | 66 |
| Unrealised value movements on investments held by other operations | **2** | 11 |
| | **25** | 105 |

## G Costs of terminated AIA transaction

The following costs were incurred in relation to the proposed, and subsequently terminated transaction, to purchase AIA Group Limited and related rights issue.

| | **2010** £m |
|---|---|
| AIG termination break fee | **153** |
| Underwriting fees | **58** |
| Costs associated with foreign exchange hedging | **100** |
| Adviser fees and other | **66** |
| Total costs before tax | **377** |
| Associated tax relief | **(93)** |
| Total costs after tax | **284** |

Of the £377 million total costs before tax, the £100 million associated with foreign exchange hedging has been recorded within "Investment return" and the other £277 million has been recorded as "Other expenditure" within "Acquisition costs and other expenditure" in the consolidated income statement.

## H Change to the Group's holding in PruHealth

On 1 August 2010, Discovery Holdings of South Africa, the Group's joint venture partner in its investment in PruHealth, completed the acquisition of the entire share capital of Standard Life Healthcare, a wholly-owned subsidiary of the Standard Life Group, for £138 million. Discovery funded the purchase of the Standard Life Healthcare transaction, and contributed Standard Life Healthcare to PruHealth as a capital investment on completion. As a result of the transaction, Discovery have increased their shareholding in PruHealth from the previous level of 50 per cent to 75 per cent, and Prudential's shareholding has been reduced from 50 per cent of the previous joint venture structure to 25 per cent of the new structure with the much enlarged business.

As a result of this dilution in holding and the consequential loss of control, PruHealth has been reclassified from a joint venture to an associate and the entity is no longer proportionally consolidated from the date of the transaction. In accordance with IAS 31 "Interests in joint ventures" a gain of £30 million arises upon the dilution, representing the difference between the fair value of the enlarged 25 per cent investment still held and the book value of the original 50 per cent investment holding.

## I Acquisition costs and other expenditure

| | **2010** | 2009 |
|---|---|---|
| | £m | £m |
| Acquisition costs incurred | **2,024** | 1,796 |
| Acquisition costs deferred less amortisation of acquisition costs | **(918)** | (763) |
| Administration costs and other expenditure | **3,496** | 2,924 |
| Movements in amounts attributable to external unit holders | **197** | 615 |
| Total acquisition costs and other expenditure | **4,799** | 4,572 |

The acquisition costs as shown on the table above relate to policy acquisition costs. Acquisition costs from business combinations are included within other expenditure.

The total amounts for acquisition costs and other expenditure shown above includes Corporate Expenditure shown in note C (Segment disclosure – income statement).The charge for Corporate Expenditure comprises:

| | **2010** | 2009 |
|---|---|---|
| | £m | £m |
| Group head office | | |
| Regular and project costs | **(147)** | (140) |
| Provision for property leases and other non-recurrent items | **(25)** | (6) |
| | **(172)** | (146) |
| Asia regional office | | |
| Gross costs | **(90)** | (95) |
| Recharges to Asia operations | **42** | 38 |
| | **(48)** | (57) |
| Total | **(220)** | (203) |

## J Sale of Taiwan agency business in 2009

In 2009, the Company sold the assets and liabilities of its agency distribution business and its agency force in Taiwan to China Life Insurance Company Ltd of Taiwan for the nominal sum of NT$1. In addition, the Company invested £45 million to purchase a 9.99 per cent stake in China Life through a share placement. The sale was completed on 19 June 2009.

The Company retained its interest in life insurance business in Taiwan through its retained bank distribution partnerships and its direct investment in China Life made in 2009. At 31 December 2010 the Company's interest in China Life was 8.66 per cent (31 December 2009: 9.99 per cent).

The effects on the IFRS income statement was a pre-tax loss of £621 million comprising a loss on sale of £559 million and trading losses before tax up to the date of sale of £62 million. After allowing for tax and other adjustments, the reduction to shareholders equity was £607 million.

The loss on sale of £559 million included cumulative foreign exchange gains of £9 million recycled through the profit and loss account as required by IAS 21.

## K Tax

**(i)** Tax charge

The total tax charge comprises:

| **Tax charge** | **2010** £m | 2009 £m |
|---|---|---|
| UK tax | **(313)** | (895) |
| Overseas tax | **(323)** | 22 |
| Total tax charge* | **(636)** | (873) |

An analysis of the total tax expense attributable to continuing operations recognised in the income statement by nature of expense is as follows:

| | **2010** £m | 2009 £m |
|---|---|---|
| Current tax | **(91)** | (529) |
| Deferred tax | **(545)** | (344) |
| Total tax charge* | **(636)** | (873) |

*The 2010 tax charge attributable to shareholders' return includes an exceptional tax credit of £158 million which primarily relates to the impact of a settlement agreed with the UK Tax authorities.

The current tax charge of £91 million includes £13 million for 2010 (2009: charge of £6 million) in respect of the tax charge for Hong Kong. The Hong Kong current tax charge is calculated as 16.5 per cent for all periods on either (i) five per cent of the net insurance premium or (ii) the estimated assessable profits, depending on the nature of the business written.

The 2010 total tax charge comprises tax attributable to policyholders and unallocated surplus of with-profits funds, unit-linked policies and shareholders. The tax charge attributable to shareholders of £25 million for 2010 (2009: charge of £55 million) comprises:

| **Tax charge attributable to shareholders** | **2010** £m | 2009 £m |
|---|---|---|
| UK tax | **187** | (176) |
| Overseas tax | **(212)** | 121 |
| Total tax charge | **(25)** | (55) |

**(ii)** Deferred tax

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

| | **2010** | | 2009 | |
|---|---|---|---|---|
| | **Deferred tax assets** £m | **Deferred tax liabilities** £m | Deferred tax assets £m | Deferred tax liabilities £m |
| Unrealised gains and losses on investments | **449** | **(1,678)** | 1,156 | (1,744) |
| Balances relating to investment and insurance contracts | **11** | **(1,057)** | 20 | (961) |
| Short-term timing differences | **1,152** | **(1,477)** | 1,228 | (1,159) |
| Capital allowances | **16** | **(12)** | 18 | (8) |
| Unused tax losses | **560** | **–** | 286 | – |
| Total | **2,188** | **(4,224)** | 2,708 | (3,872) |

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

The taxation regimes applicable across the Group often apply separate rules to trading and capital profits and losses. The distinction between temporary differences that arise from items of either a trading or capital nature may affect the recognition of deferred tax assets. Accordingly, for the 2010 results and financial position at 31 December 2010, the possible tax benefit of approximately £143 million (31 December 2009: £257 million), which may arise from capital losses valued at approximately £0.5 billion (31 December 2009: £1.2 billion), is sufficiently uncertain that it has not been recognised. In addition, a potential deferred tax asset of £298 million (31 December 2009: £607 million), which may arise from tax losses and other potential temporary differences totalling £1.2 billion (31 December 2009: £2.1 billion) is sufficiently uncertain that it has not been recognised. Forecasts as to when these tax losses and other temporary differences are likely to be utilised indicate that they may not be utilised in the short term.

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

The UK government's tax rate change to 27 per cent has had the effect of reducing the UK with-profits and shareholder-backed business elements of the net deferred tax balances as at 31 December 2010 by £11 million. The tax change to 27 per cent is effective from 1 April 2011 but has been enacted at 31 December 2010. The subsequent proposed phased rate changes to 24 per cent are expected to have the effect of reducing the UK with-profits and shareholder-backed business elements of the net deferred tax balances at 31 December 2010 by £65 million.

**(iii)** Reconciliation of tax charge on profit attributable to shareholders for continuing operations

| 2010 | Asian insurance operations | US insurance operations | UK insurance operations | Other operations | Total |
|---|---|---|---|---|---|
| | | £m (except for tax rates) | | | |
| Profit (loss) before tax attributable to shareholders: | | | | | |
| Operating profit based on longer-term investment returns (note (iii)) | **532** | **833** | **719** | **(143)** | **1,941** |
| Short-term fluctuations in investment returns | **114** | **(378)** | **116** | **25** | **(123)** |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | **-** | **-** | **(5)** | **(5)** | **(10)** |
| Costs of terminated AIA transaction | **-** | **-** | **-** | **(377)** | **(377)** |
| Gain on dilution of holding in PruHealth | **-** | **-** | **30** | **-** | **30** |
| Total | **646** | **455** | **860** | **(500)** | **1,461** |
| Expected tax rate: (note (i)) | | | | | |
| Operating profit based on longer-term investment returns (note (iii)) | **22%** | **35%** | **28%** | **28%** | **29%** |
| Short-term fluctuations in investment returns | **25%** | **35%** | **28%** | **28%** | **52%** |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | **-** | **-** | **28%** | **28%** | **20%** |
| Costs of terminated AIA transaction | **-** | **-** | **-** | **28%** | **28%** |
| Gain on dilution of holding in PruHealth | **-** | **-** | **28%** | **-** | **28%** |
| Expected tax (charge) credit based on expected tax rates: | | | | | |
| Operating profit based on longer-term investment returns (note (iii)) | **(117)** | **(292)** | **(201)** | **40** | **(570)** |
| Short-term fluctuations in investment returns | **(29)** | **132** | **(32)** | **(7)** | **64** |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | **-** | **-** | **1** | **1** | **2** |
| Costs of terminated AIA transaction | **-** | **-** | **-** | **106** | **106** |
| Gain on dilution of holding in PruHealth | **-** | **-** | **(8)** | **-** | **(8)** |
| Total | **(146)** | **(160)** | **(240)** | **140** | **(406)** |
| Variance from expected tax charge: (note (ii)) | | | | | |
| Operating profit based on longer-term investment returns (note (iii)) | **59** | **43** | **18** | **237** | **357** |
| Short-term fluctuations in investment returns | **21** | **-** | **-** | **7** | **28** |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | **-** | **-** | **-** | **1** | **1** |
| Costs of terminated AIA transaction | **-** | **-** | **-** | **(13)** | **(13)** |
| Gain on dilution of holding in PruHealth | **-** | **-** | **8** | **-** | **8** |
| Total | **80** | **43** | **26** | **232** | **381** |
| Actual tax (charge) credit: | | | | | |
| Operating profit based on longer-term investment returns, excluding exceptional tax credit (note (iii)) | **(58)** | **(249)** | **(183)** | **119** | **(371)** |
| Exceptional tax credit* | **-** | **-** | **-** | **158** | **158** |
| Operating profit based on longer-term investment return | **(58)** | **(249)** | **(183)** | **277** | **(213)** |
| Short-term fluctuations in investment returns | **(8)** | **132** | **(32)** | **-** | **92** |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | **-** | **-** | **1** | **2** | **3** |
| Costs of terminated AIA transaction | **-** | **-** | **-** | **93** | **93** |
| Gain on dilution of holding in PruHealth | **-** | **-** | **-** | **-** | **-** |
| Total | **(66)** | **(117)** | **(214)** | **372** | **(25)** |
| Actual tax rate: | | | | | |
| Operating profit based on longer-term investment returns | **11%** | **30%** | **25%** | **194%** | **11%** |
| Total profit | **10%** | **26%** | **25%** | **74%** | **2%** |
| Actual tax rate (excluding exceptional tax credit*): | | | | | |
| Operating profit based on longer-term investment returns | **11%** | **30%** | **25%** | **83%** | **19%** |
| Total profit | **10%** | **26%** | **25%** | **43%** | **13%** |

*The tax charge attributable to shareholders' return includes an exceptional tax credit of £158 million which primarily relates to the impact of settlement agreed with the UK tax authorities.

| 2009* | Asian insurance operations | US insurance operations | UK insurance operations | Other operations | Total |
|---|---|---|---|---|---|
| | | £m (Except for tax rates) | | | |
| Profit (loss) before tax attributable to shareholders: | | | | | |
| Operating profit based on longer-term investment returns (note (iii)) | 410 | 618 | 657 | (121) | 1,564 |
| Short-term fluctuations in investment returns | 31 | (132) | 108 | (130) | (123) |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | – | – | (46) | (28) | (74) |
| Loss on sale and results for Taiwan agency business | (621) | – | – | – | (621) |
| Total | (180) | 486 | 719 | (279) | 746 |
| Expected tax rate: (note (i)) | | | | | |
| Operating profit based on longer-term investment returns (note (iii)) | 24% | 35% | 28% | 28% | 30% |
| Short-term fluctuations in investment returns | 25% | 35% | 28% | 36% | 45% |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | – | – | 28% | 28% | 28% |
| Loss on sale and results for Taiwan agency business | 25% | – | – | – | 25% |
| Expected tax (charge) credit based on expected tax rates: | | | | | |
| Operating profit based on longer-term investment returns (note (iii)) | (98) | (216) | (184) | 34 | (464) |
| Short-term fluctuations in investment returns | (8) | 46 | (30) | 47 | 55 |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | – | – | 13 | 8 | 21 |
| Loss on sale and results for Taiwan agency business | 155 | – | – | – | 155 |
| Total | 49 | (170) | (201) | 89 | (233) |
| Variance from expected tax charge: (note (ii)) | | | | | |
| Operating profit based on longer-term investment returns (note (iii)) | 35 | 76 | (29) | 8 | 90 |
| Short-term fluctuations in investment returns | 15 | 196 | – | 14 | 225 |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | – | – | – | – | – |
| Loss on sale and results for Taiwan agency business | (137) | – | – | – | (137) |
| Total | (87) | 272 | (29) | 22 | 178 |
| Actual tax (charge) credit: | | | | | |
| Operating profit based on longer-term investment returns (note (iii)) | (63) | (140) | (213) | 42 | (374) |
| Short-term fluctuations in investment returns | 7 | 242 | (30) | 61 | 280 |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | – | – | 13 | 8 | 21 |
| Loss on sale and results for Taiwan agency business | 18 | – | – | – | 18 |
| Total | (38) | 102 | (230) | 111 | (55) |
| Actual tax rate: | | | | | |
| Operating profit based on longer-term investment returns | 15% | 23% | 32% | 35% | 24% |
| Total profit | (21)% | (21)% | 32% | 40% | 7% |

*The Group has amended the presentation of operating profit for its US insurance operations to remove the net equity accounting effect (incorporating related amortisation of deferred acquisition costs) and included it in short-term fluctuations. The 2009 comparatives have been amended accordingly. Note C explains the effect of the change.

**Notes**

(i) *Expected tax rates for profit (loss) attributable to shareholders:*

- The expected tax rates shown in the table above reflect the corporation tax rates generally applied to taxable profits of the relevant country jurisdictions.
- For Asian operations the expected tax rates reflect the corporation tax rates weighted by reference to the source of profits of operations contributing to the aggregate business result.
- The expected tax rate for Other operations reflects the mix of business between UK and overseas operations, which are taxed at a variety of rates. The rates will fluctuate from year to year dependent on the mix of profits.

(ii) *For 2010 and 2009, the principal variances arise from a number of factors, including:*

(a) Asian long-term operations
For 2010 and 2009, profits in certain countries which are not taxable partly offset by the inability to fully recognise deferred tax assets on losses being carried forward.

(b) Jackson
For 2010, the benefit of a deduction from taxable income of a proportion of dividends received attributable to the variable annuity business. For 2009, the ability to fully recognise deferred tax assets on losses brought forward which we were previously unable to recognise together with income subject to a lower level of taxation and the benefit of a deduction from taxable income of a proportion of dividends received attributable to the variable annuity business.

(c) UK insurance operations

For 2010, routine revisions to prior period tax returns. For 2009, adjustments in respect of prior year tax charge and different tax bases of UK life business.

(d) Other operations
For 2010, an exceptional tax credit which primarily relates to the impact of the settlement agreed with the UK tax authorities and the ability to recognise a deferred tax credit on various tax losses which we were previously unable to recognise, partly offset by the inability to fully recognise a tax credit in respect of non deductable capital costs incurred in relation to the terminated AIA transaction. For 2009, the ability to recognise a deferred tax asset on various tax losses which we were previously unable to recognise partly offset by adjustments in respect of the prior year tax charge.

(e) For 2009, the actual tax rate in relation to Asia excluding the result for the sold Taiwan agency business would have been 13 per cent.

(iii) Operating profit based on longer-term investment returns is net of attributable restructuring costs and development expenses.

## L Supplementary analysis of earnings per share

| | 2010 | | | | | |
|---|---|---|---|---|---|---|
| | **Before tax** (note C) | **Tax** (note K) | **Non-controlling interests** | **Net of tax and non-controlling interests** | **Basic earnings per share** | **Diluted earnings per share** |
| | £m | £m | £m | £m | Pence | Pence |
| Based on operating profit based on longer-term investment returns, excluding exceptional tax credit | **1,941** | **(371)** | **(5)** | **1,565** | **62.0 p** | **61.9 p** |
| Exceptional tax credit* | **-** | **158** | **-** | **158** | **6.3 p** | **6.3 p** |
| Based on operating profit based on longer-term investment return | **1,941** | **(213)** | **(5)** | **1,723** | **68.3 p** | **68.2 p** |
| Short-term fluctuations in investment returns on shareholder-backed business | **(123)** | **92** | **-** | **(31)** | **(1.2)p** | **(1.2)p** |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | **(10)** | **3** | **-** | **(7)** | **(0.3)p** | **(0.3)p** |
| Costs of terminated AIA transaction | **(377)** | **93** | **-** | **(284)** | **(11.3)p** | **(11.3)p** |
| Gain on dilution of holding in PruHealth | **30** | **-** | **-** | **30** | **1.2 p** | **1.2 p** |
| Based on profit for the year from continuing operations including exceptional tax credit | **1,461** | **(25)** | **(5)** | **1,431** | **56.7 p** | **56.6 p** |

*The tax charge attributable to shareholders' return includes an exceptional tax credit of £158 million which primarily relates to the impact of a settlement agreed with the UK tax authorities.

| | 2009 ** | | | | | |
|---|---|---|---|---|---|---|
| | Before tax (note C) | Tax (note K) | Non-controlling interests | Net of tax and non-controlling interests | Basic earnings per share | Diluted earnings per share |
| | £m | £m | £m | £m | Pence | Pence |
| Based on operating profit based on longer-term investment returns | 1,564 | (374) | (2) | 1,188 | 47.5 p | 47.4 p |
| Short-term fluctuations in investment returns on shareholder-backed business | (123) | 280 | 1 | 158 | 6.3 p | 6.3 p |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | (74) | 21 | – | (53) | (2.1)p | (2.1)p |
| Adjustment from loss on sale and result of Taiwan agency business | (621) | 18 | – | (603) | (24.1)p | (24.0)p |
| Based on profit for the year from continuing operations | 746 | (55) | (1) | 690 | 27.6 p | 27.6 p |
| Adjustment for post-tax results of discontinued operations | (14) | – | – | (14) | (0.6)p | (0.6)p |
| Based on profit for the year from continuing operations | 732 | (55) | (1) | 676 | 27.0 p | 27.0 p |

**The Group has amended the presentation of operating profit for its US insurance operations to remove the net equity hedge accounting effect (incorporating related amortisation of deferred acquisition costs) and include it in short-term fluctuations. The 2009 comparatives have been amended accordingly. Note C explains the effect of the change.

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

The weighted average number of shares for calculating basic earnings per share for 2010 was 2,524 million (2009: 2,501 million). The weighted average number of shares for calculating diluted earnings per share for 2010 was 2,529 million (2009: 2,506 million).

## M Dividend

| **Dividends per share (in pence)** | **2010** | 2009 |
|---|---|---|
| Dividends relating to reporting year: | | |
| Interim dividend (2010 and 2009) | **6.61 p** | 6.29 p |
| Final /Second interim dividend (2010 and 2009) | **17.24 p** | 13.56 p |
| Total | **23.85 p** | 19.85 p |
| Dividends declared and paid in reporting year: | | |
| Current year interim dividend | **6.61 p** | 6.29 p |
| Second interim /final dividend for prior year | **13.56 p** | 12.91 p |
| Total | **20.17 p** | 19.20 p |

Interim dividends are recorded in the period in which they are paid. Final dividends are recorded in the period in which they are approved by shareholders. The second interim dividend of 13.56 pence per ordinary share for the year ended 31 December 2009 was paid to eligible shareholders on 27 May 2010 and the 2010 interim dividend of 6.61 pence per ordinary share was paid to eligible shareholders on 23 September 2010.

Following the Board's decision to rebase the dividend upwards and subject to shareholders' approval, the 2010 final dividend of 17.24 pence per ordinary share will be paid on 26 May 2011 in sterling to shareholders on the principal and Irish branch registers at 6.00 p.m BST on Friday, 1 April 2011 (the "Record Date"), and in Hong Kong dollars to shareholders on the Hong Kong branch register at 4.30 p.m Hong Kong time on the Record Date ("HK Shareholders"). Holders of US American Depositary Receipts ("US Shareholders") will be paid their dividends in US dollars on or about five days after the payment date of the dividend to shareholders on the principal register. The final dividend will be paid on or about 2 June 2011 in Singapore dollars to shareholders with shares standing to the credit of their securities accounts with The Central Depository (Pte.) Limited ("CDP") at 5.00 p.m Singapore time on the Record Date ("SG Shareholders"). The dividend payable to the HK Shareholders will be translated at the exchange rate ruling at the close of business on 8 March 2011. The exchange rate at which the dividend payable to the SG Shareholders will be translated into SG$ will be determined by CDP. The dividend will distribute an estimated £439 million of shareholders' funds.

The scrip dividend is not being offered in respect of this dividend. In its place shareholders will be offered a Dividend Reinvestment Plan (DRIP).

## N Group statement of financial position analysis

**(i)** Group statement of financial position analysis

To explain more comprehensively the assets, liabilities and capital of the Group's businesses, it is appropriate to provide analyses of the Group's statement of financial position by operating segment and type of business.

Position at 31 December 2010:

| | Insurance operations | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | UK | US | Asia | Total insurance operations | Asset management operations | Unallocated to a segment (central operations) | Intra -group eliminations | 2010 Group total | 2009 Group total |
| **By operating segment** | £m | £m | £m | £m | £m | £m | £m | £m | £m |
| **Assets** | | | | | | | | | |
| Intangible assets attributable to shareholders: | | | | | | | | | |
| Goodwill (note Q) | - | - | 236 | 236 | 1,230 | - | - | 1,466 | 1,310 |
| Deferred acquisition costs and other intangible assets (note R) | 118 | 3,543 | 939 | 4,600 | 9 | - | - | 4,609 | 4,049 |
| Total | 118 | 3,543 | 1,175 | 4,836 | 1,239 | - | - | 6,075 | 5,359 |
| Intangible assets attributable to with-profits funds: | | | | | | | | | |
| In respect of acquired subsidiaries for venture fund and other investment purposes | 166 | - | - | 166 | - | - | - | 166 | 124 |
| Deferred acquisition costs and other intangible assets | 13 | - | 97 | 110 | - | - | - | 110 | 106 |
| Total | 179 | - | 97 | 276 | - | - | - | 276 | 230 |
| Total | 297 | 3,543 | 1,272 | 5,112 | 1,239 | - | - | 6,351 | 5,589 |
| Deferred tax assets (note K) | 214 | 1,391 | 98 | 1,703 | 123 | 362 | - | 2,188 | 2,708 |
| Other non investment and non-cash assets | 4,633 | 1,241 | 811 | 6,685 | 999 | 4,159 | (5,761) | 6,082 | 5,425 |
| Investment of long term business and other operations: | | | | | | | | | |
| Investment properties | 11,212 | 26 | 9 | 11,247 | - | - | - | 11,247 | 10,905 |
| Investments accounted for using the equity method | 69 | - | 2 | 71 | - | - | - | 71 | 6 |
| Financial investments: | | | | | | | | | |
| Loans (note T) | 2,302 | 4,201 | 1,340 | 7,843 | 1,418 | - | - | 9,261 | 8,754 |
| Equity securities and portfolio holdings in unit trusts | 40,519 | 31,501 | 14,464 | 86,484 | 151 | - | - | 86,635 | 69,354 |
| Debt securities (note U) | 74,304 | 26,366 | 14,108 | 114,778 | 1,574 | - | - | 116,352 | 101,751 |
| Other investments | 3,998 | 1,199 | 382 | 5,579 | 59 | 141 | - | 5,779 | 5,132 |
| Deposits | 9,022 | 212 | 638 | 9,872 | 80 | - | - | 9,952 | 12,820 |
| Total investments | 141,426 | 63,505 | 30,943 | 235,874 | 3,282 | 141 | - | 239,297 | 208,722 |
| Properties held for sale | 254 | 3 | - | 257 | - | - | - | 257 | 3 |
| Cash and cash equivalents | 2,839 | 232 | 1,601 | 4,672 | 1,436 | 523 | - | 6,631 | 5,307 |
| **Total assets** | 149,663 | 69,915 | 34,725 | 254,303 | 7,079 | 5,185 | (5,761) | 260,806 | 227,754 |

**Further segmental analysis:**

The non-current assets of the Group comprise goodwill, intangible assets other than DAC and present value of acquired in-force business and property, plant and equipment included within 'other non-investment and non-cash assets'. Items defined as financial instruments or related to insurance contracts are excluded. Of the Group's total non-current assets at 31 December 2010 of £2,454 million (2009: £1,965 million), £1,708 million (2009: £1,444 million) was held in the UK by the UK insurance operations, M&G and central operations, £131 million (2009: £112 million) was held in the US and £615 million (2009: £409 million) was held in Asia.

No individual country in Asia held non-current assets at the end of the year which exceeds 10 per cent of the Group total.

| By operating segment | Insurance operations UK | US | Asia | Total insurance operations | Asset management operations | Unallocated to a segment (central operations) | Intra -group eliminations | 2010 Group total | 2009 Group total |
|---|---|---|---|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m | £m | £m | £m | £m |
| **Equity and liabilities** | | | | | | | | | |
| ***Equity*** | | | | | | | | | |
| Shareholders' equity | **2,148** | **3,815** | **2,149** | **8,112** | **1,787** | **(1,868)** | **-** | **8,031** | 6,271 |
| Non-controlling interests | **35** | **-** | **5** | **40** | **4** | **-** | **-** | **44** | 32 |
| Total equity | **2,183** | **3,815** | **2,154** | **8,152** | **1,791** | **(1,868)** | **-** | **8,075** | 6,303 |
| ***Liabilities*** | | | | | | | | | |
| Policyholder liabilities and unallocated surplus of with-profits funds: | | | | | | | | | |
| Insurance contract liabilities | **84,152** | **58,641** | **28,498** | **171,291** | **-** | **-** | **-** | **171,291** | 145,713 |
| Investment contract liabilities with discretionary participation features | **25,613** | **-** | **119** | **25,732** | **-** | **-** | **-** | **25,732** | 24,880 |
| Investment contract liabilities without discretionary participation features | **15,765** | **1,882** | **57** | **17,704** | **-** | **-** | **-** | **17,704** | 15,805 |
| Unallocated surplus of with-profits funds (reflecting application of 'realistic' basis provisions for UK regulated with-profits funds) | **10,187** | **-** | **66** | **10,253** | **-** | **-** | **-** | **10,253** | 10,019 |
| Total policyholder liabilities and unallocated surplus of with-profits funds | **135,717** | **60,523** | **28,740** | **224,980** | **-** | **-** | **-** | **224,980** | 196,417 |
| Core structural borrowings of shareholder financed operations: | | | | | | | | | |
| Subordinated debt | **-** | **-** | **-** | **-** | **-** | **2,718** | **-** | **2,718** | 2,691 |
| Other | **-** | **159** | **-** | **159** | **250** | **549** | **-** | **958** | 703 |
| Total (note W) | **-** | **159** | **-** | **159** | **250** | **3,267** | **-** | **3,676** | 3,394 |
| Operational borrowings attributable to shareholder financed operations (note X) | **162** | **90** | **189** | **441** | **3** | **2,560** | **-** | **3,004** | 2,751 |
| Borrowings attributable to with-profits operations (note X) | **1,522** | **-** | **-** | **1,522** | **-** | **-** | **-** | **1,522** | 1,284 |
| Other non-insurance liabilities: | | | | | | | | | |
| Obligations under funding, securities lending and sale and repurchase agreements | **2,398** | **1,801** | **-** | **4,199** | **-** | **-** | **-** | **4,199** | 3,482 |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | **1,755** | **33** | **1,126** | **2,914** | **458** | **-** | **-** | **3,372** | 3,809 |
| Deferred tax liabilities (note K) | **1,738** | **1,776** | **495** | **4,009** | **5** | **210** | **-** | **4,224** | 3,872 |
| Current tax liabilities (note K) | **399** | **34** | **70** | **503** | **33** | **295** | **-** | **831** | 1,215 |
| Accruals and deferred income | **340** | **-** | **109** | **449** | **244** | **14** | **-** | **707** | 594 |
| Other creditors | **1,939** | **511** | **1,122** | **3,572** | **4,039** | **471** | **(5,761)** | **2,321** | 1,612 |
| Provisions | **442** | **19** | **61** | **522** | **157** | **50** | **-** | **729** | 643 |
| Derivative liabilities | **792** | **799** | **222** | **1,813** | **78** | **146** | **-** | **2,037** | 1,501 |
| Other liabilities | **276** | **355** | **437** | **1,068** | **21** | **40** | **-** | **1,129** | 877 |
| Total | **10,079** | **5,328** | **3,642** | **19,049** | **5,035** | **1,226** | **(5,761)** | **19,549** | 17,605 |
| Total liabilities | **147,480** | **66,100** | **32,571** | **246,151** | **5,288** | **7,053** | **(5,761)** | **252,731** | 221,451 |
| **Total equity and liabilities** | **149,663** | **69,915** | **34,725** | **254,303** | **7,079** | **5,185** | **(5,761)** | **260,806** | 227,754 |

## (ii) Group statement of financial position - additional analysis by business type

| | Participating funds £m | Shareholder-backed business: Unit-linked and variable annuity £m | Non-linked business £m | Asset management operations £m | Unallocated to a segment (central operations) £m | Intra-group eliminations £m | 2010 Group total £m | 2009 Group total £m |
|---|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | | |
| Intangible assets attributable to shareholders: | | | | | | | | |
| Goodwill (note Q) | - | - | 236 | 1,230 | - | - | 1,466 | 1,310 |
| Deferred acquisition costs and other intangible assets (note R) | - | - | 4,600 | 9 | - | - | 4,609 | 4,049 |
| Total | - | - | 4,836 | 1,239 | - | - | 6,075 | 5,359 |
| Intangible assets attributable to with-profits funds: | | | | | | | | |
| In respect of acquired subsidiaries for venture fund and other investment purposes | 166 | - | - | - | - | - | 166 | 124 |
| Deferred acquisition costs and other intangible assets | 110 | - | - | - | - | - | 110 | 106 |
| Total | 276 | - | - | - | - | - | 276 | 230 |
| Total | 276 | - | 4,836 | 1,239 | - | - | 6,351 | 5,589 |
| Deferred tax assets (note K) | 109 | - | 1,594 | 123 | 362 | - | 2,188 | 2,708 |
| Other non investment and non-cash assets | 2,749 | 651 | 3,285 | 999 | 4,159 | (5,761) | 6,082 | 5,425 |
| Investment of long term business and other operations: | | | | | | | | |
| Investment properties | 8,993 | 745 | 1,509 | - | - | - | 11,247 | 10,905 |
| Investments accounted for using the equity method | - | - | 71 | - | - | - | 71 | 6 |
| Financial investments: | | | | | | | | |
| Loans (note T) | 2,144 | - | 5,699 | 1,418 | - | - | 9,261 | 8,754 |
| Equity securities and portfolio holdings in unit trusts | 31,371 | 54,274 | 839 | 151 | - | - | 86,635 | 69,354 |
| Debt securities (note U) | 53,261 | 9,054 | 52,463 | 1,574 | - | - | 116,352 | 101,751 |
| Other investments | 3,887 | 131 | 1,561 | 59 | 141 | - | 5,779 | 5,132 |
| Deposits | 7,272 | 749 | 1,851 | 80 | - | - | 9,952 | 12,820 |
| Total investments | 106,928 | 64,953 | 63,993 | 3,282 | 141 | - | 239,297 | 208,722 |
| Properties held for sale | 254 | - | 3 | - | - | - | 257 | 3 |
| Cash and cash equivalents | 1,915 | 1,490 | 1,267 | 1,436 | 523 | - | 6,631 | 5,307 |
| **Total assets** | **112,231** | **67,094** | **74,978** | **7,079** | **5,185** | **(5,761)** | **260,806** | 227,754 |

| | Participating funds £m | Shareholder-backed business: Unit-linked and variable annuity £m | Non-linked business £m | Asset management operations £m | Unallocated to a segment (central operations) £m | Intra-group eliminations £m | 2010 Group total £m | 2009 Group total £m |
|---|---|---|---|---|---|---|---|---|
| **Equity and liabilities** | | | | | | | | |
| ***Equity*** | | | | | | | | |
| Shareholders' equity | - | - | 8,112 | 1,787 | (1,868) | - | 8,031 | 6,271 |
| Non-controlling interests | 35 | - | 5 | 4 | - | - | 44 | 32 |
| Total equity | 35 | - | 8,117 | 1,791 | (1,868) | - | 8,075 | 6,303 |
| ***Liabilities*** | | | | | | | | |
| Policyholder liabilities and unallocated surplus of with-profits funds: | | | | | | | | |
| Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4) | 92,544 | 65,598 | 56,585 | - | - | - | 214,727 | 186,398 |
| Unallocated surplus of with-profits funds (reflecting application of 'realistic' basis provisions for UK regulated with-profits funds) | 10,253 | - | - | - | - | - | 10,253 | 10,019 |
| Total policyholder liabilities and unallocated surplus of with-profits funds | 102,797 | 65,598 | 56,585 | - | - | - | 224,980 | 196,417 |
| Core structural borrowings of shareholder-financed operations: (note W) | | | | | | | | |
| Subordinated debt | - | - | - | - | 2,718 | - | 2,718 | 2,691 |
| Other | - | - | 159 | 250 | 549 | - | 958 | 703 |
| Total | - | - | 159 | 250 | 3,267 | - | 3,676 | 3,394 |
| Operational borrowings attributable to shareholder financed operations (note X) | - | - | 441 | 3 | 2,560 | - | 3,004 | 2,751 |
| Borrowings attributable to with-profits operations (note X) | 1,522 | - | - | - | - | - | 1,522 | 1,284 |
| Deferred tax liabilities | 1,576 | 25 | 2,408 | 5 | 210 | - | 4,224 | 3,872 |
| Other non-insurance liabilities | 6,301 | 1,471 | 7,268 | 5,030 | 1,016 | (5,761) | 15,325 | 13,733 |
| Total liabilities | 112,196 | 67,094 | 66,861 | 5,288 | 7,053 | (5,761) | 252,731 | 221,451 |
| **Total equity and liabilities** | **112,231** | **67,094** | **74,978** | **7,079** | **5,185** | **(5,761)** | **260,806** | 227,754 |

## O Statement of financial position at 31 December 2010

### (i) UK insurance operations

<u>Overview</u>

- In order to reflect the different types of UK business and fund structure, the statement of financial position of the UK insurance operations analyses assets and liabilities between those of the Scottish Amicable Insurance Fund (SAIF), the PAC with-profits sub-fund (WPSF), unit-linked assets and liabilities and annuity (principally PRIL) and other long-term business.

- £94.8 billion of the £141.4 billion of investments are held by SAIF and the PAC WPSF. Shareholders are exposed only indirectly to value movements on these assets.

| | | **PAC with-profits fund** (note (i)) | | | **Other funds and subsidiaries** | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **By operating segment** | **Scottish Amicable Insurance Fund** (note (ii)) £m | **Excluding Prudential Annuities Limited** £m | **Prudential Annuities Limited** (note (iii)) £m | **Total** (note (iv)) £m | **Unit-linked assets and liabilities** £m | **Annuity and other long-term business** £m | **Total** £m | **2010 Total** £m | 2009 Total £m |
| **Assets** | | | | | | | | | |
| Intangible assets attributable to shareholders: | | | | | | | | | |
| Deferred acquisition costs and other intangible assets | - | - | - | - | - | **118** | **118** | **118** | 127 |
| Total | - | - | - | - | - | **118** | **118** | **118** | 127 |
| Intangible assets attributable to with-profits funds: | | | | | | | | | |
| In respect of acquired subsidiaries for venture fund and other investment purposes | - | **166** | - | **166** | - | - | - | **166** | 124 |
| Deferred acquisition costs | - | **13** | - | **13** | - | - | - | **13** | 9 |
| Total | - | **179** | - | **179** | - | - | - | **179** | 133 |
| Total | - | **179** | - | **179** | - | **118** | **118** | **297** | 260 |
| Deferred tax assets | **2** | **93** | **14** | **107** | - | **105** | **105** | **214** | 292 |
| Other non investment and non-cash assets | **412** | **1,810** | **322** | **2,132** | **557** | **1,532** | **2,089** | **4,633** | 3,074 |
| Investment of long term business and other operations: | | | | | | | | | |
| Investment properties | **673** | **7,589** | **731** | **8,320** | **745** | **1,474** | **2,219** | **11,212** | 10,861 |
| Investments accounted for using the equity method | - | - | - | - | - | **69** | **69** | **69** | 4 |
| Financial investments: | | | | | | | | | |
| Loans (note T) | **153** | **979** | **138** | **1,117** | - | **1,032** | **1,032** | **2,302** | 1,815 |
| Equity securities and portfolio holdings in unit trusts | **3,105** | **23,716** | **229** | **23,945** | **13,434** | **35** | **13,469** | **40,519** | 37,051 |
| Debt securities (note U) | **4,704** | **29,013** | **12,785** | **41,798** | **6,045** | **21,757** | **27,802** | **74,304** | 67,772 |
| Other investments (note (v)) | **276** | **3,241** | **178** | **3,419** | **73** | **230** | **303** | **3,998** | 3,630 |
| Deposits | **793** | **6,038** | **435** | **6,473** | **498** | **1,258** | **1,756** | **9,022** | 11,557 |
| Total investments | **9,704** | **70,576** | **14,496** | **85,072** | **20,795** | **25,855** | **46,650** | **141,426** | 132,690 |
| Properties held for sale | - | **254** | - | **254** | - | - | - | **254** | - |
| Cash and cash equivalents | **170** | **1,127** | **82** | **1,209** | **1,153** | **307** | **1,460** | **2,839** | 2,265 |
| **Total assets** | **10,288** | **74,039** | **14,914** | **88,953** | **22,505** | **27,917** | **50,422** | **149,663** | 138,581 |

| | | PAC with-profits fund (note (i)) | | | Other funds and subsidiaries | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Scottish Amicable Insurance Fund (note (ii)) £m | Excluding Prudential Annuities Limited £m | Prudential Annuities Limited (note (iii)) £m | Total (note (iv)) £m | Unit-inked assets and liabilities £m | Annuity and other long-term business £m | Total £m | 2010 Group Total £m | 2009 Group Total £m |
| **Equity and liabilities** | | | | | | | | | |
| ***Equity*** | | | | | | | | | |
| Shareholders' equity | **-** | **-** | **-** | **-** | **-** | **2,148** | **2,148** | **2,148** | 1,939 |
| Non-controlling interests | **-** | **35** | **-** | **35** | **-** | **-** | **-** | **35** | 28 |
| Total equity | **-** | **35** | **-** | **35** | **-** | **2,148** | **2,148** | **2,183** | 1,967 |
| ***Liabilities*** | | | | | | | | | |
| Policyholder liabilities and unallocated surplus of with-profits funds: | | | | | | | | | |
| Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4) | **9,759** | **59,545** | **12,282** | **71,827** | **21,671** | **22,273** | **43,944** | **125,530** | 116,229 |
| Unallocated surplus of with-profits funds (reflecting application of 'realistic' basis provisions for UK regulated with-profits funds) (note (vi)) | **-** | **8,363** | **1,824** | **10,187** | **-** | **-** | **-** | **10,187** | 9,966 |
| Total | **9,759** | **67,908** | **14,106** | **82,014** | **21,671** | **22,273** | **43,944** | **135,717** | 126,195 |
| Operational borrowings attributable to shareholder financed operations | **-** | **-** | **-** | **-** | **-** | **162** | **162** | **162** | 158 |
| Borrowings attributable to with-profits funds | **118** | **1,404** | **-** | **1,404** | **-** | **-** | **-** | **1,522** | 1,284 |
| Deferred tax liabilities | **80** | **903** | **252** | **1,155** | **-** | **503** | **503** | **1,738** | 1,606 |
| Other non-insurance liabilities | **331** | **3,789** | **556** | **4,345** | **834** | **2,831** | **3,665** | **8,341** | 7,371 |
| Total liabilities | **10,288** | **74,004** | **14,914** | **88,918** | **22,505** | **25,769** | **48,274** | **147,480** | 136,614 |
| **Total equity and liabilities** | **10,288** | **74,039** | **14,914** | **88,953** | **22,505** | **27,917** | **50,422** | **149,663** | 138,581 |

**Notes**

(i) For the purposes of this table and subsequent explanation, references to the WPSF also include, for convenience, the amounts attaching to the Defined Charges Participating Sub-fund which comprises 3.5 per cent of the total assets of the WPSF and includes the with-profits annuity business transferred to Prudential from the Equitable Life Assurance Society on 1 December 2007 (with assets of approximately £1.7 billion). Profits to shareholders on this with-profits annuity business emerge on a 'charges less expenses' basis and policyholders are entitled to 100 per cent of the investment earnings.

(ii) SAIF is a separate sub-fund within the PAC long-term business fund.

(iii) Wholly-owned subsidiary of the PAC WPSF that writes annuity business.

(iv) Excluding policyholder liabilities of the Hong Kong branch of PAC.

(v) Other investment comprise:

| | 2010 £m | 2009 £m |
|---|---|---|
| Derivative assets* | **926** | 910 |
| Partnerships in investment pools and other** | **3,072** | 2,720 |
| | **3,998** | 3,630 |

* In the UK, Prudential uses derivatives to reduce equity and credit risk, interest rate and currency exposures, and to facilitate efficient portfolio management. After derivative liabilities of £792 million (2009: £709 million), which are also included in the statement of financial position, the overall derivative position was a net asset of £134 million (2009: £201 million).

** Partnerships in investment pools and other comprise mainly investments held by the PAC with-profits fund. These investments are primarily investments in limited partnerships and additionally, investments in property funds.

(vi) *Unallocated surplus of with-profits funds*
Prudential's long-term business written in the UK comprises predominantly life insurance policies under which the policyholders are entitled to participate in the returns of the funds supporting these policies. Business similar to this type is also written in certain of the Group's Asian operations, subject to local market and regulatory conditions. Such policies are called with-profits policies. Prudential maintains with-profits funds within the Group's long-term business funds, which segregate the assets and liabilities and accumulate the returns related to that with-profits business. The amounts accumulated in these with-profits funds are available to provide for future policyholder benefit provisions and for bonuses to be distributed to with-profits policyholders. The bonuses, both annual and final, reflect the right of the with-profits policyholders to participate in the financial performance of the with-profits funds. Shareholders' profits with respect to bonuses declared on with-profits business correspond to the shareholders' share of the cost of bonuses as declared by the Board of Directors. The shareholders' share currently represents one-ninth of the cost of bonuses declared for with-profits policies.

The unallocated surplus represents the excess of assets over policyholder liabilities for the Group's with-profits funds. As allowed under IFRS 4, the Group has opted to continue to record unallocated surplus of with-profits funds wholly as a liability. The annual excess (shortfall) of income over expenditure of the with-profits funds, after declaration and attribution of the cost of bonuses to policyholders and shareholders, is transferred to (from) the unallocated surplus each year through a charge (credit) to the income statement. The balance retained in the unallocated surplus represents cumulative income arising on the with-profits business that has not been allocated to policyholders or shareholders. The balance of the unallocated surplus is determined after full provision for deferred tax on unrealised appreciation of investments.

**(ii)** US insurance operations

| | 2010 | | | 2009 |
|---|---|---|---|---|
| | **Variable annuity separate account assets and liabilities** (note (i)) £m | **Fixed annuity, GIC and other business** (note (i)) £m | **Total** £m | Total £m |
| **Assets** | | | | |
| Intangible assets attributable to shareholders: | | | | |
| Deferred acquisition costs | **-** | **3,543** | **3,543** | 3,092 |
| Total | **-** | **3,543** | **3,543** | 3,092 |
| Deferred tax assets | **-** | **1,391** | **1,391** | 1,944 |
| Other non-investment and non-cash assets | **-** | **1,241** | **1,241** | 1,404 |
| Investments of long-term business and other operations: | | | | |
| Investment properties | **-** | **26** | **26** | 33 |
| Financial investments: | | | | |
| Loans (note T) | **-** | **4,201** | **4,201** | 4,319 |
| Equity securities and portfolio holdings in unit trusts (note (iv)) | **31,203** | **298** | **31,501** | 20,984 |
| Debt securities (note U) | **-** | **26,366** | **26,366** | 22,831 |
| Other investments (note (ii)) | **-** | **1,199** | **1,199** | 955 |
| Deposits | **-** | **212** | **212** | 454 |
| Total investments | **31,203** | **32,302** | **63,505** | 49,576 |
| Properties held for sale | **-** | **3** | **3** | 3 |
| Cash and cash equivalents | **-** | **232** | **232** | 340 |
| **Total assets** | **31,203** | **38,712** | **69,915** | 56,359 |
| **Equity and liabilities** | | | | |
| ***Equity*** | | | | |
| Shareholders' equity) (note (iii)) | **-** | **3,815** | **3,815** | 3,011 |
| Total equity | **-** | **3,815** | **3,815** | 3,011 |
| ***Liabilities*** | | | | |
| Policyholder: | | | | |
| Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4) | **31,203** | **29,320** | **60,523** | 48,311 |
| Total | **31,203** | **29,320** | **60,523** | 48,311 |
| Core structural borrowings of shareholder-financed operations | **-** | **159** | **159** | 154 |
| Operational borrowings attributable to shareholder-financed operations | **-** | **90** | **90** | 203 |
| Deferred tax liabilities | **-** | **1,776** | **1,776** | 1,858 |
| Other non-insurance liabilities | **-** | **3,552** | **3,552** | 2,822 |
| Total liabilities | **31,203** | **34,897** | **66,100** | 53,348 |
| **Total equity and liabilities** | **31,203** | **38,712** | **69,915** | 56,359 |

**Notes**

(i) Assets and liabilities attaching to variable annuity business that are not held in the separate account are shown within other business.

(ii) Other investments comprise:

| | **2010** | 2009 |
|---|---|---|
| | £m | £m |
| Derivative assets* | **645** | 519 |
| Partnerships in investment pools and other** | **554** | 436 |
| | **1,199** | 955 |

* In the US, Prudential uses derivatives to reduce interest rate risk, to facilitate efficient portfolio management to match liabilities under annuity policies, and for certain equity-based product management activities. After taking account of the derivative liability of £799 million (2009: £461 million), which is also included in the statement of financial position, the derivative position for US operations is a net liability of £154 million (2009: £58 million).

** Partnerships in investment pools and other comprise primarily investments in limited partnerships. These include interests in the PPM America Private Equity Fund and diversified investments in 161 (2009: 159) other partnerships by independent money managers that generally invest in various equities and fixed income loans and securities.

(iii) *Changes in shareholders' equity*

| | **2010** | 2009* |
|---|---|---|
| | £m | £m |
| Operating profits based on longer-term investment returns (note C) | **833** | 618 |
| Short-term fluctuations in investment returns (note F) | **(378)** | (132) |
| Profit before shareholder tax | **455** | 486 |
| Tax (note K) | **(117)** | 102 |
| Profit for the year | **338** | 588 |

| | **2010** | 2009 |
|---|---|---|
| | £m | £m |
| Profit for the year (as above) | **338** | 588 |
| Items recognised directly in equity: | | |
| Exchange movements | **85** | (231) |
| Unrealised valuation movements on securities classified as available-for sale: | | |
| Unrealised holding gains arising during the year | **1,170** | 2,249 |
| Less losses included in the income statement | **51** | 420 |
| Total unrealised valuation movements | **1,221** | 2,669 |
| Related change in amortisation of deferred income and acquisition costs (note R) | **(496)** | (1,069) |
| Related tax | **(247)** | (557) |
| Total other comprehensive income | **563** | 812 |
| Total comprehensive income for the year | **901** | 1,400 |
| Dividends, interest payments to central companies and other movements | **(97)** | (87) |
| Net increase in equity | **804** | 1,313 |
| Shareholders' equity at beginning of year | **3,011** | 1,698 |
| Shareholders' equity at end of year | **3,815** | 3,011 |

*The Group has amended the presentation of operating profit for its US insurance operations to remove the net equity hedge accounting effect (incorporating related amortisation of deferred acquisition costs) and include it in short-term fluctuations. The 2009 comparatives have been amended accordingly. Note C explains the effect of the change.

(iv) Equity securities and portfolio holdings in unit trusts includes investments in mutual funds, the majority of which are equity based.

**(iii)** Asian insurance operations

| | 2010 | | | | 2009 |
|---|---|---|---|---|---|
| | **With-profits business** (note (i)) | **Unit-linked assets and liabilities** | **Other** | **Total** | Total |
| | £m | £m | £m | £m | £m |
| **Assets** | | | | | |
| Intangible assets attributable to shareholders: | | | | | |
| Goodwill | **-** | **-** | **236** | **236** | 80 |
| Deferred acquisition costs and other intangible assets | **-** | **-** | **939** | **939** | 822 |
| Total | **-** | **-** | **1,175** | **1,175** | 902 |
| Intangible assets attributable to with-profits funds: | | | | | |
| Deferred acquisition costs and other intangible assets | **97** | **-** | **-** | **97** | 97 |
| Deferred tax assets | **-** | **-** | **98** | **98** | 132 |
| Other non-investment and non-cash assets | **205** | **94** | **512** | **811** | 880 |
| Investments of long-term business and other operations: | | | | | |
| Investment properties | **-** | **-** | **9** | **9** | 11 |
| Investments accounted for using the equity method | **-** | **-** | **2** | **2** | 2 |
| Financial investments: | | | | | |
| Loans (note T) | **874** | **-** | **466** | **1,340** | 1,207 |
| Equity securities and portfolio holdings in unit trusts | **4,321** | **9,637** | **506** | **14,464** | 11,182 |
| Debt securities (note U) | **6,759** | **3,009** | **4,340** | **14,108** | 9,984 |
| Other investments | **192** | **58** | **132** | **382** | 258 |
| Deposits | **6** | **251** | **381** | **638** | 746 |
| Total investments | **12,152** | **12,955** | **5,836** | **30,943** | 23,390 |
| Cash and cash equivalents | **536** | **337** | **728** | **1,601** | 837 |
| **Total assets** | **12,990** | **13,386** | **8,349** | **34,725** | 26,238 |
| **Equity and liabilities** | | | | | |
| ***Equity*** | | | | | |
| Shareholders' equity | **-** | **-** | **2,149** | **2,149** | 1,462 |
| Non-controlling interests | **-** | **-** | **5** | **5** | 1 |
| Total equity | **-** | **-** | **2,154** | **2,154** | 1,463 |
| ***Liabilities*** | | | | | |
| Policyholder liabilities and unallocated surplus of with-profits funds: | | | | | |
| Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4) | **10,958** | **12,724** | **4,992** | **28,674** | 21,858 |
| Unallocated surplus of with-profits funds | **66** | **-** | **-** | **66** | 53 |
| Total | **11,024** | **12,724** | **4,992** | **28,740** | 21,911 |
| Operational borrowings attributable to shareholders-financed operations | **-** | **-** | **189** | **189** | 210 |
| Deferred tax liabilities | **341** | **25** | **129** | **495** | 384 |
| Other non-insurance liabilities | **1,625** | **637** | **885** | **3,147** | 2,270 |
| Total liabilities | **12,990** | **13,386** | **6,195** | **32,571** | 24,775 |
| **Total equity and liabilities** | **12,990** | **13,386** | **8,349** | **34,725** | 26,238 |

**Notes**

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

## (iv) Asset management operations

| | M&G (note (i)) £m | US £m | Asia £m | Total 2010 £m | Total 2009 £m |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Intangible assets: | | | | | |
| Goodwill (note (iii)) | **1,153** | **16** | **61** | **1,230** | 1,230 |
| Deferred acquisition costs | **9** | **-** | **-** | **9** | 8 |
| Total | **1,162** | **16** | **61** | **1,239** | 1,238 |
| Other non-investment and non-cash assets (note (iii)) | **854** | **174** | **94** | **1,122** | 850 |
| Financial investments: | | | | | |
| Loans (note T) | **1,418** | **-** | **-** | **1,418** | 1,413 |
| Equity securities and portfolio holdings in unit trusts | **141** | **-** | **10** | **151** | 137 |
| Debt securities (note U) | **1,560** | **-** | **14** | **1,574** | 1,164 |
| Other investments (note (iii)) | **51** | **1** | **7** | **59** | 113 |
| Deposits | **33** | **22** | **25** | **80** | 63 |
| Total financial investments | **3,203** | **23** | **56** | **3,282** | 2,890 |
| Cash and cash equivalents (note (iii)) | **1,269** | **39** | **128** | **1,436** | 970 |
| **Total assets** | **6,488** | **252** | **339** | **7,079** | 5,948 |
| **Equity and liabilities** | | | | | |
| ***Equity*** | | | | | |
| Shareholders' equity | **1,407** | **122** | **258** | **1,787** | 1,659 |
| Non-controlling interests | **4** | **-** | **-** | **4** | 3 |
| Total equity | **1,411** | **122** | **258** | **1,791** | 1,662 |
| ***Liabilities*** | | | | | |
| Core structural borrowing of shareholder-financed operations | **250** | **-** | **-** | **250** | - |
| Intra-group debt represented by operational borrowings at Group level (note (ii)) | **2,560** | **-** | **-** | **2,560** | 2,038 |
| Net asset value attributable to external holders of consolidated unit trusts and similar funds (note (iii)) | **458** | **-** | **-** | **458** | 410 |
| Other non-insurance liabilities (note (iii)) | **1,809** | **130** | **81** | **2,020** | 1,838 |
| Total liabilities | **5,077** | **130** | **81** | **5,288** | 4,286 |
| **Total equity and liabilities** | **6,488** | **252** | **339** | **7,079** | 5,948 |

**Notes**

(i) M&G includes those assets and liabilities in respect of Prudential Capital.

(ii) *Intra group debt represented by operational borrowings at Group level*
Operational borrowings for M&G are in respect of Prudential Capital's short-term fixed income security programme and comprise £2,311 million (2009: £2,031 million) of commercial paper and £249 million (2009: £7 million) of medium-term notes.

(iii) *Consolidated investment funds*
The M&G statement of financial position shown above includes investment funds which are managed on behalf of third-parties. In respect of these funds, the statement of financial position includes cash and cash equivalents of £304 million (2009: £269 million), £167 million (2009: £158 million) of other investments, £(13) million (2009: £(17) million) of other net assets and liabilities and the net asset value attributable to external unit holders of £458 million (2009: £410 million), which are non-recourse to M&G and the Group.

## P Acquisition of United Overseas Bank Life Assurance Limited

On 1 February 2010, the Group acquired from United Overseas Bank (UOB) its 100 per cent interest in UOB Life Assurance Limited in Singapore for total cash consideration, after post-completion adjustments of SGD67 million (£32 million), of SGD495 million (£220 million). As part of the transaction the Group also entered into a long-term strategic partnership to develop a major regional bancassurance business with UOB.

In addition to the amounts above the Group incurred £2 million of acquisition-related costs (excluding integration costs). These have been excluded from the consideration transferred and have been recognised as an expense in the period, in the consolidated income statement.

### Goodwill arising on acquisition

| | £m |
|---|---|
| Cash consideration | **220** |
| Less: fair value of identifiable net assets acquired | **(79)** |
| Goodwill arising on acquisition | **141** |

Goodwill arose on the acquisition of UOB Life Assurance Limited in Singapore because the acquisition included revenue and cost synergies. These synergies could not be recognised as assets separately from goodwill because they are not capable of being separated from the Group and sold, transferred, licensed, rented or exchanged, either individually or together with any related contracts and did not arise from contractual or other legal rights.

None of the goodwill arising on this transaction is expected to be deductible for tax purposes.

### Assets acquired and liabilities assumed at the date of acquisition

| | £m |
|---|---|
| Assets: | |
| Intangible assets attributable to shareholders: Present value of acquired in-force business | **12** |
| Other non-investment and non-cash assets | **16** |
| Investments of long-term business and other operations | **1,004** |
| Cash and cash equivalents | **89** |
| Total assets | **1,121** |
| | |
| Liabilities: | |
| Policyholder liabilities | **968** |
| Other non-insurance liabilities | **74** |
| Total liabilities | **1,042** |
| **Fair value of identifiable net assets acquired** | **79** |

Total assets include loans and receivables with a fair value of £15 million. This value represents the gross contractual amount and all amounts have been collected.

The consolidated statement of cash flows contains a £133 million net cash outflow in respect of this acquisition representing cash consideration of £220 million, acquisition related costs paid of £2 million less cash and cash equivalents acquired of £89 million.

### Impact of acquisition on the results of the Group

Included in the Group's consolidated profit before tax for the year is £8 million attributable to UOB Life Assurance Limited in Singapore. Consolidated revenue, including investment returns, for the year includes £125 million in respect of UOB Life Assurance Limited in Singapore.

Had the acquisition been effected at 1 January 2010, the revenue and profit of the Group from continuing operations for the year ended 31 December 2010 would not have been materially different.

## Q Goodwill attributable to shareholders

| | 2010 £m | 2009 £m |
|---|---|---|
| **Cost** | | |
| At 1 January | **1,430** | 1,461 |
| Disposal of Taiwan Agency business | **–** | (44) |
| Additional consideration paid on previously acquired businesses | **–** | 13 |
| Acquisition of UOB Life Assurance Limited in Singapore(note P) | **141** | – |
| Exchange differences | **15** | – |
| **At 31 December** | **1,586** | 1,430 |
| **Aggregate impairment** | | |
| At 1 January and 31 December | **(120)** | (120) |
| **Net book amount at 31 December** | **1,466** | 1,310 |

## R Deferred acquisition costs and other intangible assets attributable to shareholders

Significant costs are incurred in connection with acquiring new insurance business. Except for acquisition costs of with-profits contracts of the UK regulated with-profits funds, which are accounted for under the realistic FSA regime, these costs, which vary with, and are primarily related to, the production of new business, are capitalised and amortised against margins in future revenues on the related insurance policies. The recoverability of the asset is measured and the asset is deemed impaired if the projected future margins are less than the carrying value of the asset. To the extent that the future margins differ from those anticipated, then an adjustment to the carrying value of the deferred acquisition cost asset will be necessary.

The deferral and amortisation of acquisition costs is of most relevance to the Group's results for shareholder-financed long-term business of Jackson and Asian operations. The majority of the UK shareholder-backed business is individual and group annuity business where the incidence of acquisition costs is negligible.

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

| | 2010 £m | 2009 £m |
|---|---|---|
| Deferred acquisition costs (DAC) related to insurance contracts as classified under IFRS 4 | **4,316** | 3,823 |
| Deferred acquisition costs related to investment management contracts, including life assurance contracts classified as financial instruments and investment management contracts under IFRS 4 | **110** | 107 |
| | **4,426** | 3,930 |
| Present value of acquired in-force policies for insurance contracts as classified under IFRS 4 | **70** | 52 |
| Present value of future profits of acquired investment management contracts, including life assurance contracts classified as financial instruments and investment management contracts under IFRS 4 | **-** | 1 |
| Distribution rights | **113** | 66 |
| | **183** | 119 |
| Total of deferred acquisition costs and other intangible assets | **4,609** | 4,049 |

| | Deferred acquisition costs | | | | | | |
|---|---|---|---|---|---|---|---|
| | **UK** £m | **US**(i) £m | **Asia** £m | **Asset management** £m | **Other intangibles** (ii) £m | **Total 2010** £m | Total 2009 £m |
| **Balance at 1 January** | 124 | 3,092 | 706 | 8 | 119 | **4,049** | 5,349 |
| Additions | 19 | 851 | 210 | 5 | 50 | **1,135** | 1,071 |
| Acquisition of UOB Life Assurance Ltd | - | - | - | - | 12 | **12** | - |
| Amortisation to the income statement: | | | | | | | |
| Operating profit | (20) | (334) | (208) | (4) | (13) | **(579)** | (469) |
| Amortisation related to short-term fluctuations in investment returns | - | 358 | - | - | - | **358** | 153 |
| | (20) | 24 | (208) | (4) | (13) | **(221)** | (316) |
| Exchange differences | - | 72 | 50 | - | 15 | **137** | (550) |
| Change in shadow DAC related to movement in unrealised appreciation of Jackson's securities classified as available-for-sale | - | (496) | - | - | - | **(496)** | (1,069) |
| Dilution of holding in PruHealth | (7) | - | - | - | - | **(7)** | - |
| DAC movement on sale of Taiwan agency business | - | - | - | - | - | **-** | (436) |
| **Balance at 31 December** | 116 | 3,543 | 758 | 9 | 183 | **4,609** | 4,049 |

(i) The DAC amount in respect of US insurance operations includes £2,834 million (2009: £1,938 million) in respect of variable annuity business, £1,229 million (2009: £1,164 million) in respect of other business and £(520) million (2009: £(10) million) in respect of cumulative shadow DAC.

(ii) In addition to the acquired assets and liabilities of UOB Life Assurance in 2010 as explained in note P, the Group entered into distribution agreements with UOB for consideration of SGD 110 million (£50 million). The distribution rights have been accounted for as an intangible asset.

Under IFRS 4, the Group applies grandfathered US GAAP for measuring the insurance assets and liabilities of Jackson. In the case of Jackson term business, acquisition costs are deferred and amortised in line with expected premiums. For annuity and interest-sensitive life business, acquisition costs are deferred and amortised in line with a combination of historical and future expected gross profits on the relevant contracts. For fixed and indexed annuity and interest-sensitive life business, the key assumption is the long-term spread between the earned rate on investments and the rate credited to policyholders, which is based on an annual spread analysis. Expected gross profits also depend on mortality assumptions, assumed unit costs and terminations other than deaths (including the related charges), all of which are based on a combination of actual experience of Jackson, industry experience and future expectations. A detailed analysis of actual mortality, lapse, and expense experience is performed using internally developed experience studies.

As with fixed and indexed annuity and interest-sensitive life business, acquisition costs for Jackson's variable annuity products are amortised in line with the emergence of profits. The measurement of the amortisation in part reflects current period fees (including those for guaranteed minimum death, income, or withdrawal benefits) earned on assets covering liabilities to policyholders, and the historical and expected level of future gross profits which depends on the assumed level of future fees, as well as components related to mortality, lapse, and expense.

Under US GAAP (as grandfathered under IFRS 4) the projected gross profits reflect an assumed long-term level of equity return which, for Jackson, is 8.4 per cent after deduction of net external fund management fees. This is applied to the period end level of separate account equity assets after application of a mean reversion technique that removes a portion of the effect of levels of short-term variability in current market returns. Under the mean reversion technique applied by Jackson, the projected level of return for each of the next five years is adjusted from period to period so that in combination with the actual rates of return for the preceding two years and the current year, the 8.4 per cent annual return is realised on average over the entire eight year period. Projected returns after the mean reversion period revert back to the 8.4 per cent target. A capping feature, which currently applies due to the very sharp market falls in 2008, is that the projected rates of return for the next five years can be no more than 15 per cent (gross of asset management fees) per annum. If Jackson had not applied the mean reversion methodology and had instead applied a constant 8.4 per cent annual return from today’s asset values, of the Jackson DAC balance of £3,543 million would fall approximately £80 million to £3,463 million at 31 December 2010.

The amortisation charge to the income statement is reflected in operating profit and short-term fluctuations in investment returns. The amortisation charge to the operating profit in a reporting period will incorporate an element of acceleration or deceleration that reflects the variance between the actual level of return attained and the assumed level in the mean reversion calculation. In 2010, the element of DAC amortisation charge included in operating profit includes £11 million of accelerated amortisation. This amount reflects actual separate account return shortfalls in the periods compared with the assumed level of 15 per cent for the year. For 2009, reflecting the excess of actual separate account returns over the 15 per cent assumed level, the operating profit incorporates a credit for decelerated amortisation of £39 million.

For 2010, the separate account return (gross of asset management fees) was approximately 13 per cent. In 2011, while the capping feature is in effect, each one per cent divergence of the actual separate account return below or above the assumed return of 15 per cent is estimated to give rise to accelerated or decelerated amortisation, respectively, of approximately £6 million (£3 million if the projected rate falls below the 15 per cent cap).

In the absence of significant market declines between now and the end of 2011, Jackson would expect to see higher amortisation levels than normal in 2011. This would essentially represent a reversal of the mean reversion benefits to date, as at that point highly negative returns from 2008 will no longer be included in the mean reverting return calculation.

## S Valuation bases for Group assets

The accounting carrying values of the Group's assets reflect the requirements of IFRS. For financial investments the basis of valuation reflects the Group's application of IAS 39 ('Financial Instruments: Recognition and Measurement') as described further below. The basis applied for the assets section of the statement of financial position at 31 December 2010 is summarised below:

| | 2010 | | | 2009 | | |
|---|---|---|---|---|---|---|
| | **At fair value** | **Cost / Amortised cost** (note (ii)) | **Total** | **At fair value** | **Cost / Amortised cost** (note (ii)) | **Total** |
| | £m | £m | £m | £m | £m | £m |
| Intangible assets attributable to shareholders: | | | | | | |
| Goodwill (note Q) | **-** | **1,466** | **1,466** | – | 1,310 | 1,310 |
| Deferred acquisition costs and other intangible assets (note R) | **-** | **4,609** | **4,609** | – | 4,049 | 4,049 |
| Total | **-** | **6,075** | **6,075** | – | 5,359 | 5,359 |
| Intangible assets attributable to with-profits funds: | | | | | | |
| In respect of acquired subsidiaries for venture fund and other investment purposes | **-** | **166** | **166** | – | 124 | 124 |
| Deferred acquisition costs and other intangible assets | | **110** | **110** | – | 106 | 106 |
| Total | **-** | **276** | **276** | – | 230 | 230 |
| Total | **-** | **6,351** | **6,351** | – | 5,589 | 5,589 |
| Other non-investment and non-cash assets: | | | | | | |
| Property, plant and equipment | **-** | **612** | **612** | – | 367 | 367 |
| Reinsurers' share of insurance contract liabilities | **-** | **1,344** | **1,344** | – | 1,187 | 1,187 |
| Deferred tax assets (note K) | **-** | **2,188** | **2,188** | – | 2,708 | 2,708 |
| Current tax recoverable | **-** | **555** | **555** | – | 636 | 636 |
| Accrued investment income | **-** | **2,668** | **2,668** | – | 2,473 | 2,473 |
| Other debtors | **-** | **903** | **903** | – | 762 | 762 |
| Total | **-** | **8,270** | **8,270** | – | 8,133 | 8,133 |
| Investments of long-term business and other operations: | | | | | | |
| Investment properties | **11,247** | **-** | **11,247** | 10,905 | – | 10,905 |
| Investments accounted for using the equity method | **-** | **71** | **71** | – | 6 | 6 |
| Financial investments: | | | | | | |
| Loans (notes (iii) and T) | **227** | **9,034** | **9,261** | – | 8,754 | 8,754 |
| Equity securities and portfolio holdings in unit trusts (note (iii)) | **86,635** | **-** | **86,635** | 69,354 | – | 69,354 |
| Debt securities (notes (iii) and U) | **116,352** | **-** | **116,352** | 101,751 | – | 101,751 |
| Other investments (note (iii)) | **5,779** | **-** | **5,779** | 5,132 | – | 5,132 |
| Deposits (note (i)) | **-** | **9,952** | **9,952** | – | 12,820 | 12,820 |
| Total | **220,240** | **19,057** | **239,297** | 187,142 | 21,580 | 208,722 |
| Properties held for sale | **257** | **-** | **257** | 3 | – | 3 |
| Cash and cash equivalents (note (i)) | **-** | **6,631** | **6,631** | – | 5,307 | 5,307 |
| **Total assets** | **220,497** | **40,309** | **260,806** | 187,145 | 40,609 | 227,754 |
| Percentage of Group total assets | **85%** | **15%** | **100%** | 82% | 18% | 100% |

**Notes**

(i) Under IAS 39, deposits and cash and cash equivalents are classified as loans and receivables and carried at amortised cost in the statement of financial position. There is no difference between their carrying values and fair values. Including these amounts as being at their fair values, the percentage of the Group's total assets held on the statement of financial position which were at fair value at 31 December 2010 was 91 per cent (2009: 90 per cent).

(ii) Assets carried at cost or amortised cost are subject to impairment testing where appropriate under IFRS requirements. This category also includes assets which are valued by reference to specific IFRS standards such as reinsurers' share of insurance contract liabilities, deferred tax assets and investments accounted for under the equity method.

(iii) These assets comprise financial instruments requiring fair value valuation under IAS 39 with a value of £209.0 billion (2009: £176.2 billion).

### Determination of fair value

The fair values of the financial assets and liabilities of the Group have been determined on the following bases.

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

The fair value estimates are made at a specific point in time, based upon available market information and judgments about the financial instruments, including estimates of the timing and amount of expected future cash flows and the credit standing of counterparties. Such estimates do not reflect any premium or discount that could result from offering for sale at one time the Group's entire holdings of a particular financial instrument, nor do they consider the tax impact of the realisation of unrealised gains or losses from selling the financial instrument being fair valued. In some cases the disclosed value cannot be realised in immediate settlement of the financial instrument.

The loans and receivables have been shown net of provisions for impairment. The fair value of loans has been estimated from discounted cash flows expected to be received. The rate of discount used was the market rate of interest.

The estimated fair value of derivative financial instruments reflects the estimated amount the Group would receive or pay in an arm's length transaction. This amount is determined using quoted prices if exchange listed, quotations from independent third-parties or valued internally using standard market practices. In accordance with the Group's risk management framework, all internally generated valuations are subject to assessment against external counterparties' valuations.

For investment contracts in the US with fixed and guaranteed terms the fair value is determined based on the present value of future cash flows discounted at current interest rates.

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

**Level 1, 2 and 3 fair value measurement hierarchy of Group financial instruments**

The table below includes financial instruments carried at fair value analysed by level of the IFRS 7 defined fair value hierarchy. This hierarchy is based on the inputs to the fair value measurement and reflects the lowest level input that is significant to that measurement.

The classification criteria and its application to Prudential can be summarised as follows:

**Level 1 – quoted prices (unadjusted) in active markets for identical assets and liabilities**

Level 1 principally includes exchange listed equities, mutual funds with quoted prices, exchange traded derivatives such as futures and options, and national government bonds unless there is evidence that trading in a given instrument is so infrequent that the market could not possibly be considered active. It also includes other financial instruments (including net assets attributable to unit holders of consolidated unit trusts and similar funds) where there is clear evidence that the year end valuation is based on a traded price in an active market.

**Level 2 – inputs other than quoted prices included within level 1 that are observable either directly (i.e. as prices) or indirectly (i.e. derived from prices)**

Level 2 principally includes corporate bonds and other non-national government debt securities which are valued using observable inputs, together with over-the-counter derivatives such as forward exchange contracts and non-quoted investment funds valued with observable inputs. It also includes net assets attributable to unit-holders of consolidated unit trusts and similar funds and investment contract liabilities that are valued using observable inputs.

The nature of Prudential's operations in the US and the UK mean that a significant proportion of the assets backing non-linked shareholder backed business are held in corporate bonds, structured securities and other non-national government debt securities. These assets, in line with market practice, are generally valued using independent pricing providers in the US and third-party broker quotes in the UK and Asia either directly or via third parties, such as IDC or Bloomberg. Such assets are generally classified as level 2 as the nature of these quotations means that they do not strictly meet the definition of level 1 assets. These valuations are determined using independent external quotations from multiple sources and are subject to a number of monitoring controls, such as monthly price variances, stale price reviews and variance analysis on prices achieved on subsequent trades.

Pricing services, where available, are used to obtain the third-party broker quotes. Where pricing services providers are used, a single valuation is obtained and applied.

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

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

In addition level 2 includes debt securities that are valued internally using standard market practices. Of the total level 2 debt securities of £89,948 million at 31 December 2010 (2009: £83,301 million), £6,638 million are valued internally (2009: £6,426 million). The majority of such securities are valued using matrix pricing, which is based on assessing the credit quality of the underlying borrower to derive a suitable discount rate relative to government securities of a comparable duration. Under matrix pricing, the debt securities are priced taking the credit spreads on comparable quoted public debt securities and applying these to the equivalent debt instruments factoring a specified liquidity premium. The majority of the parameters used in this valuation technique are readily observable in the market and, therefore, are not subject to interpretation.

**Level 3 – Significant inputs for the asset or liability that are not based on observable market data (unobservable inputs)**

Level 3 principally includes investments in private equity funds, investments in property funds which are exposed to bespoke properties or risks, investments which are internally valued or subject to a significant number of unobservable assumptions and certain derivatives which are bespoke or long dated. It also includes debt securities which are rarely traded or traded only in privately negotiated transactions and hence where it is difficult to assert that these have been based on observable market data. The inherent nature of the vast majority of these assets means that, in normal market conditions, there is unlikely to be significant change in the specific underlying assets classified as level 3.

At 31 December 2010 the Group held £4,194 million (2009: £5,190 million), two per cent of the fair valued financial instruments (2009: three per cent), within level 3. Of these amounts £3,359 million (2009: £3,510 million) was held by the Group's participating funds and therefore shareholders' profit and equity are not impacted by movements in the valuation of these financial instruments. Total level 3 assets represented 3.3 per cent of the total assets of the participating funds at 31 December 2010 (2009: 3.7 per cent). Total level 3 liabilities at 31 December 2010 were £371 million out of total participating fund liabilities of £112,196 million (2009: £348 million out of £104,817 million).

Of the £866 million level 3 fair valued financial investments at 31 December 2010 (2009: £1,684 million), net of derivative liabilities which support non-linked shareholder-backed business (1.6 per cent of the total financial investments net of derivative liabilities backing this business) (2009: 3.6 per cent), £728 million are externally valued and £138 million are internally valued (2009: £1,653 million and £31 million respectively). Internal valuations, which represent 0.2 per cent of the total financial investments net of derivative liabilities supporting non-linked shareholder-backed business at 31 December 2010 (2009: 0.04 per cent), are inherently more subjective than external valuations.

| | 31 December 2010 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| | £m | £m | £m | £m |
| **With-profits** | | | | |
| Equity securities and portfolio holdings in unit trusts | **29,675** | **1,281** | **415** | **31,371** |
| Debt securities | **11,114** | **41,375** | **772** | **53,261** |
| Other investments (including derivative assets) | **137** | **1,207** | **2,543** | **3,887** |
| Derivative liabilities | **(56)** | **(626)** | **(25)** | **(707)** |
| Total financial investments, net of derivative liabilities | **40,870** | **43,237** | **3,705** | **87,812** |
| Borrowings attributable to the with-profits fund held at fair value | **-** | **(82)** | **-** | **(82)** |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | **(519)** | **(511)** | **(346)** | **(1,376)** |
| Total | **40,351** | **42,644** | **3,359** | **86,354** |
| Percentage of total | **47%** | **49%** | **4%** | **100%** |
| **Unit-linked and variable annuity separate account** | | | | |
| Equity securities and portfolio holdings in unit trusts | **54,272** | **2** | **-** | **54,274** |
| Debt securities | **3,784** | **5,268** | **2** | **9,054** |
| Other investments (including derivative assets) | **43** | **88** | **-** | **131** |
| Total financial investments, net of derivative liabilities | **58,099** | **5,358** | **2** | **63,459** |
| Investment contracts liabilities without discretionary participation features held at fair value | **-** | **(13,841)** | **-** | **(13,841)** |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | **(1,360)** | **-** | **-** | **(1,360)** |
| Total | **56,739** | **(8,483)** | **2** | **48,258** |
| Percentage of total | **118%** | **(18)%** | **-** | **100%** |
| **Non-linked shareholder-backed** | | | | |
| Loans | **-** | **227** | **-** | **227** |
| Equity securities and portfolio holdings in unit trusts | **808** | **21** | **161** | **990** |
| Debt securities | **10,389** | **43,305** | **343** | **54,037** |
| Other investments (including derivative assets) | **52** | **1,146** | **563** | **1,761** |
| Derivative liabilities | **(80)** | **(1,049)** | **(201)** | **(1,330)** |
| Total financial investments, net of derivative liabilities | **11,169** | **43,650** | **866** | **55,685** |
| Investment contracts liabilities without discretionary participation features held at fair value | **-** | **(1,981)** | **-** | **(1,981)** |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | **(220)** | **(383)** | **(33)** | **(636)** |
| Total | **10,949** | **41,286** | **833** | **53,068** |
| Percentage of total | **20%** | **78%** | **2%** | **100%** |
| **Group total** | | | | |
| Loans | **-** | **227** | **-** | **227** |
| Equity securities and portfolio holdings in unit trusts | **84,755** | **1,304** | **576** | **86,635** |
| Debt securities | **25,287** | **89,948** | **1,117** | **116,352** |
| Other investments (including derivative assets) | **232** | **2,441** | **3,106** | **5,779** |
| Derivative liabilities | **(136)** | **(1,675)** | **(226)** | **(2,037)** |
| Total financial investments, net of derivative liabilities | **110,138** | **92,245** | **4,573** | **206,956** |
| Borrowings attributable to the with-profits fund held at fair value | **-** | **(82)** | **-** | **(82)** |
| Investment contracts liabilities without discretionary participation features held at fair value | **-** | **(15,822)** | **-** | **(15,822)** |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | **(2,099)** | **(894)** | **(379)** | **(3,372)** |
| Total | **108,039** | **75,447** | **4,194** | **187,680** |
| Percentage of total | **58%** | **40%** | **2%** | **100%** |

| | 31 December 2009 | | | |
|---|---|---|---|---|
| | Level 1 £m | Level 2 £m | Level 3 £m | Total £m |
| **With-profits** | | | | |
| Equity securities and portfolio holdings in unit trusts | 28,688 | 799 | 475 | 29,962 |
| Debt securities | 7,063 | 39,051 | 1,213 | 47,327 |
| Other investments (including derivative assets) | 79 | 1,199 | 2,170 | 3,448 |
| Derivative liabilities | (54) | (504) | (25) | (583) |
| Total financial investments, net of derivative liabilities | 35,776 | 40,545 | 3,833 | 80,154 |
| Borrowings attributable to the with-profits fund held at fair value | – | (105) | – | (105) |
| Investment contracts liabilities without discretionary participation feature held at fair value | – | – | – | – |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | (1,354) | (305) | (323) | (1,982) |
| Total | 34,422 | 40,135 | 3,510 | 78,067 |
| Percentage of total | 44% | 51% | 5% | 100% |
| **Unit-linked and variable annuity separate account** | | | | |
| Equity securities and portfolio holdings in unit trusts | 38,616 | 4 | – | 38,620 |
| Debt securities | 3,283 | 5,525 | 40 | 8,848 |
| Other investments (including derivative assets) | 30 | 80 | – | 110 |
| Derivative liabilities | – | – | – | – |
| Total financial investments, net of derivative liabilities | 41,929 | 5,609 | 40 | 47,578 |
| Investment contracts liabilities without discretionary participation features held at fair value | – | (12,242) | – | (12,242) |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | (1,324) | (7) | (2) | (1,333) |
| Total | 40,605 | (6,640) | 38 | 34,003 |
| Percentage of total | 119% | -19% | 0% | 100% |
| **Non-linked shareholder-backed** | | | | |
| Equity securities and portfolio holdings in unit trusts | 557 | 36 | 179 | 772 |
| Debt securities | 5,783 | 38,725 | 1,068 | 45,576 |
| Other investments (including derivative assets) | 155 | 787 | 632 | 1,574 |
| Derivative liabilities | (20) | (703) | (195) | (918) |
| Total financial investments, net of derivative liabilities | 6,475 | 38,845 | 1,684 | 47,004 |
| Investment contracts liabilities without discretionary participation features held at fair value | – | (1,598) | – | (1,598) |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | (110) | (342) | (42) | (494) |
| Total | 6,365 | 36,905 | 1,642 | 44,912 |
| Percentage of total | 14% | 82% | 4% | 100% |
| **Group total** | | | | |
| Equity securities and portfolio holdings in unit trusts | 67,861 | 839 | 654 | 69,354 |
| Debt securities | 16,129 | 83,301 | 2,321 | 101,751 |
| Other investments (including derivative assets) | 264 | 2,066 | 2,802 | 5,132 |
| Derivative liabilities | (74) | (1,207) | (220) | (1,501) |
| Total financial investments, net of derivative liabilities | 84,180 | 84,999 | 5,557 | 174,736 |
| Borrowings attributable to the with-profits fund held at fair value | – | (105) | – | (105) |
| Investment contracts liabilities without discretionary participation features held at fair value | – | (13,840) | – | (13,840) |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | (2,788) | (654) | (367) | (3,809) |
| Total | 81,392 | 70,400 | 5,190 | 156,982 |
| Percentage of total | 52% | 45% | 3% | 100% |

## T Loans portfolio

Loans are accounted for at amortised cost net of impairment except for certain mortgage loans of the UK insurance operations which have been designated at fair value through profit and loss as this loan portfolio is managed and evaluated on a fair value basis. The amounts included in the statement of financial position are analysed as follows:

| | **2010** £m | 2009 £m |
|---|---|---|
| Insurance operations | | |
| UK(note(i)) | **2,302** | 1,815 |
| US(note (ii)) | **4,201** | 4,319 |
| Asia(note (iii)) | **1,340** | 1,207 |
| Asset management operations | | |
| M&G(note (iv)) | **1,418** | 1,413 |
| Total | **9,261** | 8,754 |

**Notes**

(i) *UK insurance operations*
The loans of the Group's UK insurance operations of £2,302 million (2009: £1,815 million) comprise loans held by the PAC WPSF of £1,270 million (2009: £1,106 million) and loans held by shareholder-backed business of £1,032 million (2009: £709 million).
The loans held by the PAC WPSF comprise mortgage loans of £256 million, policy loans of £21 million and other loans of £993 million (2009: £145 million, £24 million and £937 million respectively). The mortgage loans are collateralised by properties. Other loans held by the PAC WPSF are all commercial loans and comprise mainly syndicated loans.

The loans held by the UK shareholder-backed business comprise mortgage loans collateralised by properties of £1,027 million (2009: £702 million) and other loans of £5 million (2009: £7 million).

(ii) *US insurance operations*
The loans of the Group's US insurance operations of £4,201 million (2009: £4,319 million) comprise mortgage loans of £3,641 million, policy loans of £548 million and other loans of £12 million (2009: £3,774 million, £530 million and £15 million respectively). All of the mortgage loans are commercial mortgage loans which are collateralised by properties. The property types are mainly industrial, multi-family residential, suburban office, retail and hotel. The breakdown by property type is as follows:

| | **2010** **%** | 2009 % |
|---|---|---|
| Industrial | **31** | 32 |
| Multi-family residential | **18** | 18 |
| Office | **19** | 20 |
| Retail | **21** | 19 |
| Hotels | **10** | 10 |
| Other | **1** | 1 |
| | **100** | 100 |

The US insurance operations' commercial mortgage loan portfolio does not include any single-family residential mortgage loans and is therefore not exposed to the risk of defaults associated with residential sub-prime mortgage loans. The average loan size is £6.6 million (2009: £6.3 million). The portfolio has a current estimated average loan to value of 73 per cent (2009: 74 per cent) which provides significant cushion to withstand substantial declines in value.

The policy loans are fully secured by individual life insurance policies or annuity policies. These loans are accounted for at amortised cost, less any impairment.

(iii) *Asian insurance operations*
The loans of the Group's Asian insurance operations of £1,340 million at 31 December 2010 (2009: £1,207 million) comprise mortgage loans of £25 million, policy loans of £528 million and other loans of £787 million (2009: £13 million, £437 million and £757 million respectively). The mortgage and policy loans are secured by properties and life insurance policies respectively.

The majority of the other loans are commercial loans held by the Malaysian operation and which are all investment graded by two local rating agencies.

(iv) *M&G*
The M&G loans of £1,418 million (2009: £1,413 million) relate to loans and receivables managed by Prudential Capital. These assets are generally secured but have no external credit ratings. Internal ratings prepared by the Group's asset management operations, as part of the risk management process, are: £213 million A+ to A- (2009: £92 million), £873 million BBB+ to BBB- (2009: £835 million), £219 million BB+ to BB- (2009: £330 million) and £113 million B+ to B- (2008: £156 million).

## U Debt securities portfolio

Debt securities are carried at fair value. The amounts included in the statement of financial position are analysed as follows, with further information relating to the credit quality of the Group's debt securities at 31 December 2010 provided in the notes below.

| | 2010 £m | 2009 £m |
|---|---|---|
| Insurance operations | | |
| UK (note(i)) | **74,304** | 67,772 |
| US (note (ii)) | **26,366** | 22,831 |
| Asia (note (iii)) | **14,108** | 9,984 |
| Asset management operations (note (iv)) | **1,574** | 1,164 |
| Total | **116,352** | 101,751 |

(i) UK insurance operations

| | PAC-with-profits sub-fund | | | | Other funds and subsidiaries | | | UK insurance operations | |
|---|---|---|---|---|---|---|---|---|---|
| | Scottish Amicable Insurance Fund £m | Excluding Prudential Annuities Limited £m | Prudential Annuities Limited £m | Total £m | Unit-linked assets and liabilities £m | PRIL £m | Other annuity and long-term business £m | 2010 Total £m | 2009 Total £m |
| S&P – AAA | **1,128** | **5,741** | **3,315** | **9,056** | **2,459** | **5,224** | **966** | **18,833** | 16,091 |
| S&P – AA+ to AA- | **346** | **2,045** | **1,334** | **3,379** | **608** | **2,299** | **253** | **6,885** | 6,472 |
| S&P – A+ to A- | **1,211** | **7,568** | **3,778** | **11,346** | **1,672** | **6,467** | **812** | **21,508** | 19,693 |
| S&P – BBB+ to BBB- | **1,011** | **6,960** | **1,153** | **8,113** | **836** | **2,464** | **424** | **12,848** | 12,183 |
| S&P – Other | **359** | **2,662** | **178** | **2,840** | **34** | **149** | **21** | **3,403** | 2,667 |
| | **4,055** | **24,976** | **9,758** | **34,734** | **5,609** | **16,603** | **2,476** | **63,477** | 57,106 |
| Moody's – Aaa | **78** | **428** | **56** | **484** | **80** | **93** | **30** | **765** | 463 |
| Moody's – Aa1 to Aa3 | **9** | **81** | **51** | **132** | **52** | **141** | **26** | **360** | 276 |
| Moody's – A1 to A3 | **27** | **169** | **214** | **383** | **33** | **169** | **20** | **632** | 801 |
| Moody's – Baa1 to Baa3 | **63** | **358** | **248** | **606** | **92** | **155** | **33** | **949** | 815 |
| Moody's – Other | **16** | **116** | **31** | **147** | **10** | **57** | **3** | **233** | 339 |
| | **193** | **1,152** | **600** | **1,752** | **267** | **615** | **112** | **2,939** | 2,694 |
| Fitch | **28** | **207** | **118** | **325** | **48** | **208** | **21** | **630** | 1,022 |
| Other | **428** | **2,678** | **2,309** | **4,987** | **121** | **1,622** | **100** | **7,258** | 6,950 |
| Total debt securities | **4,704** | **29,013** | **12,785** | **41,798** | **6,045** | **19,048** | **2,709** | **74,304** | 67,772 |

Where no external ratings are available, internal ratings produced by the Group's asset management operation, which are prepared on the Company's assessment of a comparable basis to external ratings, are used where possible. Of the £7,258 million total debt securities held in 2010 (2009: £6,950 million) which are not externally rated, £2,210 million were internally rated AAA to A-, £3,861 million were internally rated BBB to B- and £1,187 million were rated below B- or unrated (2009: £2,190 million, £3,445 million and £1,315 million respectively). The majority of unrated debt security investments were held in SAIF and the PAC with-profits fund and relate to convertible debt and other investments which are not covered by ratings analysts nor have an internal rating attributed to them. Of the £1,722 million PRIL and other annuity and long-term business investments which are not externally rated, £7 million were internally rated AAA, £92 million AA, £496 million A, £899 million BBB, £82 million BB and £146 million were internally rated B+ and below.

(ii) *US insurance operations*

US insurance operations held total debt securities with a carrying value of £26,366 million at 31 December 2010 (2009: £22,831 million). The table below provides information relating to the credit risk of the aforementioned debt securities.

| Summary | 2010 £m | 2009 £m |
|---|---|---|
| Corporate and government security and commercial loans: | | |
| Government | **2,440** | 379 |
| Publicly traded and SEC Rule 144A securities | **14,747** | 12,959 |
| Non-SEC Rule 144A securities | **3,044** | 3,117 |
| Total | **20,231** | 16,455 |
| Residential mortgage-backed securities | **2,784** | 3,316 |
| Commercial mortgage-backed securities | **2,375** | 2,104 |
| Other debt securities | **976** | 956 |
| Total debt securities | **26,366** | 22,831 |

The following table summarises the securities detailed above by rating as at 31 December 2010 using Standard and Poor's (S&P), Moody's, Fitch and implicit ratings of MBS based on NAIC valuations:

| | **2010** | 2009 |
|---|---|---|
| | £m | £m |
| S&P – AAA | **4,187** | 3,287 |
| S&P – AA+ to AA- | **801** | 846 |
| S&P – A+ to A- | **5,156** | 5,192 |
| S&P – BBB+ to BBB- | **8,202** | 7,659 |
| S&P – Other | **866** | 895 |
| | **19,212** | 17,879 |
| Moody's – Aaa | **34** | 273 |
| Moody's – Aa1 to Aa3 | **32** | 43 |
| Moody's – A1 to A3 | **36** | 32 |
| Moody's – Baa1 to Baa3 | **73** | 64 |
| Moody's – Other | **135** | 57 |
| | **310** | 469 |
| Implicit ratings of MBS based on NAIC valuations (see below) | | |
| NAIC 1 | **3,083** | 747 |
| NAIC 2 | **181** | 105 |
| NAIC 3-6 | **232** | 473 |
| | **3,496** | 1,325 |
| Fitch | **176** | 281 |
| Other * | **3,172** | 2,877 |
| Total debt securities | **26,366** | 22,831 |

In the table above, with the exception of some residential mortgage-backed securities and commercial mortgage-backed securities for 2010, and for residential mortgage-backed securities for 2009 commercial mortgage-backed securities, S&P ratings have been used where available. For securities where S&P ratings are not immediately available, those produced by Moody's and then Fitch have been used as an alternative. During 2009, the NAIC in the US revised the regulatory rating process for more than 20,000 residential mortgage-backed securities. In addition in 2010, the NAIC extended the revised process to include commercial mortgage-backed securities. The table above includes these securities, where held by Jackson, using the regulatory rating levels established by external third parties (PIMCO for residential mortgage-backed securities and BlackRock Solutions for commercial mortgage-backed securities).

*The amounts within Other which are not rated by S&P, Moody or Fitch, nor are MBS securities using the revised regulatory ratings, have the following NAIC classifications:

| | **2010** | 2009 |
|---|---|---|
| | £m | £m |
| NAIC 1 | **1,193** | 1,102 |
| NAIC 2 | **1,849** | 1,623 |
| NAIC 3-6 | **130** | 152 |
| | **3,172** | 2,877 |

(iii) Asia insurance operations

| | **With-profits business** | **Unit-linked business** | **Other business** | **2010 Total** | 2009 Total |
|---|---|---|---|---|---|
| | **£m** | **£m** | **£m** | **£m** | £m |
| S&P – AAA | **2,199** | **349** | **386** | **2,934** | 2,259 |
| S&P – AA+ to AA- | **744** | **100** | **1,294** | **2,138** | 1,594 |
| S&P – A+ to A- | **1,337** | **861** | **645** | **2,843** | 1,496 |
| S&P – BBB+ to BBB- | **729** | **24** | **160** | **913** | 682 |
| S&P – Other | **649** | **465** | **659** | **1,773** | 917 |
| | **5,658** | **1,799** | **3,144** | **10,601** | 6,948 |
| Moody's – Aaa | **49** | **10** | **6** | **65** | 134 |
| Moody's – Aa1 to Aa3 | **44** | **48** | **23** | **115** | 349 |
| Moody's – A1 to A3 | **55** | **16** | **59** | **130** | 309 |
| Moody's – Baa1 to Baa3 | **50** | **10** | **35** | **95** | 40 |
| Moody's – Other | **31** | **-** | **18** | **49** | 15 |
| | **229** | **84** | **141** | **454** | 847 |
| Fitch | **4** | **33** | **12** | **49** | 39 |
| Other | **868** | **1,093** | **1,043** | **3,004** | 2,150 |
| Total debt securities | **6,759** | **3,009** | **4,340** | **14,108** | 9,984 |

Of the £1,043 million (2009: £517 million) of debt securities for other business which are not rated in the table above, £350 million (2009: £225 million) are in respect of government bonds, £666 million (2009: £265 million) are in respect of corporate bonds rated as investment grade by local external ratings agencies, and £5 million (2009: £22 million) are structured deposits issued by banks which are themselves rated but where the specific deposits have not been.

(iv) *Asset Management Operations*

Of the total debt securities of £1,574 million at 31 December 2010 (2009: £1,164 million) £1,560 million relates to M&G (2009: £1,149 million), of which £1,468 million were rated AAA to A– by Standard and Poor's or Aaa rated by Moody's (2009: £1,072 million).

(v) *Group exposure to holdings in asset-backed securities*

The Group's exposure to holdings in asset-backed securities, which comprise residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), CDO funds and other asset-backed securities (ABS), at 31 December 2010 is as follows:

| | **2010** | 2009 |
|---|---|---|
| | **£m** | £m |
| **Shareholder-backed operations (excluding assets held in unit-linked funds):** | | |
| UK insurance operations (note (a)) | **1,181** | 2,044 |
| US insurance operations (note (b)) | **6,135** | 6,376 |
| Asian insurance operations (note (c)) | **113** | 59 |
| Other operations (note (d)) | **437** | 326 |
| | **7,866** | 8,805 |
| **With-profits operations:** | | |
| UK insurance operations (note (a)) | **5,237** | 6,451 |
| Asian insurance operations (note (c)) | **435** | 378 |
| | **5,672** | 6,829 |
| Total | **13,538** | 15,634 |

(a) UK insurance operations

The UK insurance operations' exposure to asset-backed securities at 31 December 2010 comprises:

| | **2010** | 2009 |
|---|---|---|
| | £m | £m |
| Shareholder-backed business (2010: 51% AAA, 23% AA) | **1,181** | 2,044 |
| With-profits operations (2010: 52% AAA, 13% AA) | **5,237** | 6,451 |
| Total | **6,418** | 8,495 |

All of the £1,181 million (2009: £2,044 million) exposure of the shareholder-backed business relates to the UK market and primarily relates to investments held by PRIL. £3,685 million of the £5,237 million (2009: £4,695 million of the £6,451 million) exposure of the with-profits operations relates to exposure to the UK market while the remaining £1,552 million (2009: £1,756 million) relates to exposure to the US market.

(b) US insurance operations

US insurance operations' exposure to asset-backed securities at 31 December 2010 comprises:

| | **2010** | 2009 |
|---|---|---|
| | £m | £m |
| RMBS Sub-prime (2010: 40% AAA, 11% AA)** | **224** | 194 |
| Alt-A (2010: 15% AAA, 6% AA) | **415** | 443 |
| Prime including agency (2010: 79% AAA, 2% AA) | **2,145** | 2,679 |
| CMBS (2010: 36% AAA, 15% AA)** | **2,375** | 2,104 |
| CDO funds (2010: 4% AAA, 4% AA)*, including £1m exposure to sub-prime | **162** | 79 |
| Other ABS (2010: 26% AAA, 20% AA), including £37m exposure to sub-prime | **814** | 877 |
| Total | **6,135** | 6,376 |

* Including the Group's economic interest in Piedmont and other consolidated CDO funds.

** MBS ratings refer to the ratings implicit within NAIC risk-based capital valuation (see note C (a)).

(c) Asian insurance operations

The Asian insurance operations' exposure to asset-backed securities is primarily held by the with-profits operations.

The £435 million (2009: £378 million) asset-backed securities exposure of the Asian with-profit operations comprises:

| | **2010** | 2009 |
|---|---|---|
| | £m | £m |
| CMBS | **251** | 91 |
| CDO funds and ABS | **184** | 287 |
| Total | **435** | 378 |

The £435 million (2009: £378 million) includes £341 million (2009: £228 million) held by investment funds consolidated under IFRS in recognition of the control arrangements for those funds and include an amount not owned by the Group with a corresponding liability of £7 million (2009: £61 million) on the statement of financial position for net asset value attributable to external unit-holders in respect of these funds, which are non-recourse to the Group. Of the £435 million, 43 per cent (2009: £378 million, 72 per cent) are investment graded by Standard and Poor's.

(d) Other operations

Other operations' exposure to asset-backed securities at 31 December 2010 is held by Prudential Capital and comprises:

| | **2010** | 2009 |
|---|---|---|
| | **£m** | £m |
| RMBS Prime (2010: 96% AAA, 4% AA) | **197** | 91 |
| CMBS (2010: 30% AAA, 23% AA) | **184** | 193 |
| CDO funds and ABS - all without sub-prime exposure (2010: 98% AAA) | **56** | 42 |
| Total | **437** | 326 |

## V Debt securities of US insurance operations: Valuation basis, accounting presentation of gains and losses and securities in an unrealised loss position

**(i)** Valuation basis

Under IAS 39, unless categorised as 'held to maturity' or 'loans and receivables' debt securities are required to be fair valued. Where available, quoted market prices are used. However, where securities do not have an externally quoted price based on regular trades or are quoted in markets that are no longer active as a result of market conditions, IAS 39 requires that valuation techniques be applied. IFRS 7 requires classification of the fair values applied by the Group into a three level hierarchy. At 31 December 2010, 0.3 per cent of Jackson's debt securities were classified as level 3 (2009: three per cent) comprised of fair values where there are significant inputs which are not based on observable market data.

**(ii)** Accounting presentation of gains and losses

With the exception of debt securities of US insurance operations classified as 'available-for-sale' under IAS 39, unrealised value movements on the Group's investments are booked within the income statement. For with-profits operations, such value movements are reflected in changes to asset share liabilities to policyholders or the liability for unallocated surplus. For shareholder-backed operations, the unrealised value movements form part of the total return for the year booked in the profit before tax attributable to shareholders. Separately, as noted elsewhere and in note C in this announcement, and as applied previously, the Group provides an analysis of this profit distinguishing operating profit based on longer-term investment return and short-term fluctuations in investment returns.

However, for debt securities classified as 'available-for-sale', unless impaired, fair value movements are recognised in other comprehensive income. Realised gains and losses, including impairments, recorded in the income statement are as shown in note F of this announcement. This classification is applied for most of the debt securities of the Group's US insurance operations.

**(iii)** 2010 movements in unrealised gains and losses

In 2010 there was a movement in the statement of financial position value for debt securities classified as available-for-sale from a net unrealised gain of £4 million to a net unrealised gain of £1,210 million (2009: net unrealised loss of £2,897 million to a net unrealised gain of £4 million). This increase reflects the effects of tightening credit spreads in the US bond market and lower interest rates. During 2010, the gross unrealised gain in the statement of financial position increased from £970 million at 31 December 2009 to £1,580 million at 31 December 2010, while the gross unrealised loss decreased from £966 million at 31 December 2009 to £370 million at 31 December 2010.

These features are included in the table shown below of the movements in the values of available-for-sale securities.

| | 2010 | Changes in Unrealised appreciation** | Foreign exchange translation | 2009 |
|---|---|---|---|---|
| | | Reflected as part of movement in comprehensive income | | |
| | **£m** | £m | £m | £m |
| Assets fair valued at below book value | | | | |
| Book value* | **4,372** | | | 8,220 |
| Unrealised gain (loss) ((iv)(a), (b)) | **(370)** | **634** | **(38)** | (966) |
| Fair value (as included in statement of financial position) | **4,002** | | | 7,254 |
| Assets fair valued at or above book value | | | | |
| Book value* | **20,743** | | | 14,444 |
| Unrealised gain /(loss) | **1,580** | **587** | **23** | 970 |
| Fair value (as included in statement of financial position) | **22,323** | | | 15,414 |
| Total | | | | |
| Book value* | **25,115** | | | 22,664 |
| Net unrealised gain/(loss) | **1,210** | **1,221** | **(15)** | 4 |
| Fair value (as included in statement of financial position)*** | **26,325** | | | 22,668 |
| Reflected as part of movement in comprehensive income | | | | |
| Movement in unrealised appreciation | **1,221** | | | 2,669 |
| Exchange movements | **(15)** | | | 232 |
| | **1,206** | | | 2,901 |

*Book value represents cost/amortised cost of the debt securities.
**Translated at the average rate of $1.55: £1.
*** Debt securities for US operations included in the statement of financial position at 31 December 2010 of £26,366 million (2009: £22,831 million), and as referred to in note U, comprise £26,325 million (2009: £22,668 million) for securities classified as available-for-sale, as shown above, and £41 million (2009: £163 million) for securities of consolidated investment funds classified as fair value through profit and loss.

Included within the movement in gross unrealised losses for the debt securities of Jackson of £634 million (2009: £1,925 million) as shown above was a net increase in value of £84 million (2009: £72 million decrease) relating to sub-prime and Alt-A securities for which the carrying values are shown in table (iv)(a) below.

### **(iv)** Debt securities classified as available-for-sale in an unrealised loss position

The following tables show some key attributes of those securities that are in an unrealised loss position at 31 December 2010.

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

The following table shows the fair value of the debt securities in a gross unrealised loss position for various percentages of book value at 31 December:

| | **2010** | | 2009 | |
|---|---|---|---|---|
| | **Fair value** | **Unrealised loss** | Fair value | Unrealised loss |
| | £m | £m | £m | £m |
| Between 90% and 100% | **3,390** | **(102)** | 5,127 | (169) |
| Between 80% and 90% | **273** | **(44)** | 1,201 | (203) |
| Below 80% (note(d)) | **339** | **(224)** | 926 | (594) |
| Total | **4,002** | **(370)** | 7,254 | (966) |

Included within the table above are amounts relating to sub-prime and Alt-A securities of:

| | **2010** | | 2009 | |
|---|---|---|---|---|
| | **Fair value** | **Unrealised loss** | Fair value | Unrealised loss |
| | £m | £m | £m | £m |
| Between 90% and 100% | **98** | **(6)** | 102 | (3) |
| Between 80% and 90% | **55** | **(9)** | 160 | (28) |
| Below 80% (note(d)) | **56** | **(25)** | 159 | (88) |
| Total | **209** | **(40)** | 421 | (119) |

*(b) Unrealised losses by maturity of security*

| | **2010** | 2009 |
|---|---|---|
| | £m | £m |
| 1 year to 5 years | **(6)** | (29) |
| 5 years to 10 years | **(47)** | (127) |
| More than 10 years | **(49)** | (92) |
| Mortgage-backed and other debt securities | **(268)** | (718) |
| Total | **(370)** | (966) |

*(c) Age analysis of unrealised losses for the years indicated*
The following table shows the age analysis of all the unrealised losses in the portfolio by reference to the length of time the securities have been in an unrealised loss position:

| | **2010** | | | 2009 | | |
|---|---|---|---|---|---|---|
| | **Non investment grade** | **Investment grade** | **Total** | Non investment grade | Investment grade | Total |
| | £m | £m | £m | £m | £m | £m |
| Less than 6 months | **(3)** | **(67)** | **(70)** | (7) | (51) | (58) |
| 6 months to 1 year | **(2)** | **-** | **(2)** | (25) | (59) | (84) |
| 1 year to 2 years | **(13)** | **(20)** | **(33)** | (59) | (234) | (293) |
| 2 years to 3 years | **(27)** | **(55)** | **(82)** | (125) | (199) | (324) |
| More than 3 years | **(58)** | **(125)** | **(183)** | (35) | (172) | (207) |
| Total | **(103)** | **(267)** | **(370)** | (251) | (715) | (966) |

At 31 December 2010, the gross unrealised losses in the statement of financial position for the sub-prime and Alt-A securities in an unrealised loss position were £40 million (2009: £119 million), as shown above in note (a). Of these losses £1 million (2009: £21 million) relate to securities that have been in an unrealised loss position for less than one year and £39 million (2009: £98 million) to securities that have been in an unrealised loss position for more than one year.

*(d) Securities whose fair value were below 80 per cent of the book value*
As shown in the table (a) above, £224 million of the £370 million of gross unrealised losses at 31 December 2010 (2009: £594 million of the £966 million of gross unrealised losses) related to securities whose fair value was below 80 per cent of the book value. The analysis of the £224 million (2009: £594 million), by category of debt securities and by age analysis indicating the length of time for which their fair value was below 80 per cent of the book value, is as follows:

| | **2010** | | 2009 | |
|---|---|---|---|---|
| Category analysis | **Fair value** | **Unrealised loss** | Fair value | Unrealised loss |
| | £m | £m | £m | £m |
| Residential mortgage-backed securities | | | | |
| Prime (including agency) | **88** | **(39)** | 322 | (153) |
| Alt - A | **15** | **(4)** | 77 | (33) |
| Sub-prime | **41** | **(20)** | 82 | (55) |
| | **144** | **(63)** | 481 | (241) |
| Commercial mortgage-backed securities. | **8** | **(29)** | 87 | (86) |
| Other asset-backed securities | **123** | **(105)** | 183 | (188) |
| Total structured securities | **275** | **(197)** | 751 | (515) |
| Corporates | **64** | **(27)** | 175 | (79) |
| Total | **339** | **(224)** | 926 | (594) |

Age analysis of fair value being below 80 per cent for the years indicated:

| | **2010** | | 2009 | |
|---|---|---|---|---|
| | **Fair value** | **Unrealised loss** | Fair value | Unrealised loss |
| Age analysis | £m | £m | £m | £m |
| Less than 3 months | **-** | **(1)** | 153 | (45) |
| 3 months to 6 months | **-** | **-** | 5 | (3) |
| More than 6 months | **339** | **(223)** | 768 | (546) |
| | **339** | **(224)** | 926 | (594) |

## W Net core structural borrowings of shareholder-financed operations

| | 2010 £m | 2009 £m |
|---|---|---|
| Core structural borrowings of shareholder-financed operations: | | |
| Perpetual subordinated capital securities (Innovative Tier 1) note (i) | **1,463** | 1,422 |
| Subordinated notes (Lower Tier 2) note (i) | **1,255** | 1,269 |
| Subordinated debt total | **2,718** | 2,691 |
| Senior debt note (ii) | | |
| 2023 | **300** | 300 |
| 2029 | **249** | 249 |
| Holding company total note (iii) | **3,267** | 3,240 |
| PruCap bank loan note (iv) | **250** | - |
| Jackson surplus notes (Lower Tier 2) note (i) | **159** | 154 |
| Total (per consolidated statement of financial position) | **3,676** | 3,394 |
| Less: Holding company cash and short-term investments (recorded within the consolidated statement of financial position) note (v) | **(1,232)** | (1,486) |
| Net core structural borrowings of shareholder-financed operations | **2,444** | 1,908 |

**Notes**

(i) These debt classifications are consistent with the treatment of capital for regulatory purposes, as defined in the FSA handbook.

(ii) The senior debt ranks above subordinated debt in the event of liquidation.

(iii) In addition to the debt listed above, £200 million Floating Rate Notes were issued by Prudential plc in October 2010 which mature in April 2011. These Notes have been wholly subscribed by a Group subsidiary and accordingly have been eliminated on consolidation in the Group financial statements. These notes were originally issued in October 2008 and have been reissued upon their maturity.

(iv) The £250 million PruCap bank loan was made in two tranches: £135 million maturing in June 2014, currently drawn at a cost of six month £LIBOR plus 1.2 per cent and £115 million maturing in August 2012, currently drawn at a cost of twelve month £LIBOR plus 1.41 per cent.

(v) Including central finance subsidiaries.

## X Other borrowings

| | 2010 £m | 2009 £m |
|---|---|---|
| **Operational borrowings attributable to shareholder-financed operations** | | |
| Borrowings in respect of short-term fixed income securities programmes | **2,560** | 2,038 |
| Non-recourse borrowings of US operations | **90** | 203 |
| Other borrowings (note (i)) | **354** | 510 |
| Total | **3,004** | 2,751 |
| **Borrowings attributable to with-profits operations** | | |
| Non-recourse borrowings of consolidated investment funds | **1,287** | 1,016 |
| £100m 8.5% undated subordinated guaranteed bonds of the Scottish Amicable Insurance Fund | **100** | 100 |
| Other borrowings (predominantly obligations under finance leases) | **135** | 168 |
| Total | **1,522** | 1,284 |

**Note**

(i) Other borrowing includes amounts whose repayment to the lender is contingent on future surpluses emerging from certain contracts specified under the arrangement. If insufficient surplus emerges on the contracts, there is no recourse to other assets of the Group and the liability is not payable to the degree of shortfall.

## Y Defined benefit pension schemes

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

| | **2010** £m | 2009 £m |
|---|---|---|
| Economic position: | | |
| Deficit, gross of deferred tax, based on scheme assets held, including investments in Prudential insurance policies: | | |
| Attributable to the PAC with-profits fund (i.e. absorbed by the liability for unallocated surplus) | **(106)** | (122) |
| Attributable to shareholder-backed operations (i.e. shareholders' equity) | **(114)** | (128) |
| Economic deficit | **(220)** | (250) |
| Exclude: investments in Prudential insurance liabilities (offset on consolidation in the Group financial statements against insurance liabilities) | **(227)** | (187) |
| Deficit under IAS 19 included in Provisions in the statement of financial position | **(447)** | (437) |

The Group business operations operate a number of pension schemes. The largest defined benefit scheme is the principal UK scheme, namely the Prudential Staff Pension Scheme (PSPS). The Group also operates two smaller defined benefit schemes for UK employees in respect of Scottish Amicable and M&G. For all three schemes the projected unit method was used for the most recent full actuarial valuations. There is also a small defined benefit scheme in Taiwan but as part of the sale of the Taiwan agency business completed in June 2009, the Group settled the majority of the obligations under the scheme as a significant number of employees transferred out.

The underlying position on an economic basis reflects the assets (including investments in Prudential policies that are offset against liabilities to policyholders on the Group consolidation) and the liabilities of the schemes. At 31 December 2010, the investments in Prudential policies comprise £118 million (2009: £101 million) for PSPS and £227 million (2009: £187 million) for the M&G scheme.

Separately, the economic financial position also includes the effect of the application of IFRIC 14, 'IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction'. For PSPS, where there are constraints in the trust deed to prevent the company access, the surplus is not recognised and a liability for additional funding is established.

Under IFRIC 14, at 31 December 2010, the Group has not recognised the underlying PSPS surplus of £485 million, gross of deferred tax (2009: £513 million) and has recognised a liability for deficit funding to 30 June 2012 for PSPS of £47 million gross of deferred tax (2009: £75 million).

Defined benefit schemes in the UK are generally required to be subject to full actuarial valuation every three years in order to assess the appropriate level of funding for schemes in relation to their commitments. These valuations include assessments of the likely rate of return on the assets held within the separate trustee administered funds. PSPS was last actuarially valued as at 5 April 2008. This valuation demonstrated the scheme to be 106 per cent funded by reference to the Scheme Solvency Target that forms the basis of the scheme's statutory funding objective. No formal deficit plan was required. However, in recognition of the fall in value of the Scheme's investments between 5 April 2008 and the completion of the actuarial valuation, an additional funding akin to deficit funding was agreed by the Trustees. This is subject to a reassessment when the next valuation is completed. The total contributions being currently made by the Group into the scheme, representing the annual accrual cost and deficit funding, are £50 million per annum. Deficit funding for PSPS is apportioned in the ratio of 70/30 between the PAC life fund and shareholder-backed operations following detailed consideration in 2005 of the sourcing of previous contributions.

The valuation of the Scottish Amicable Pension Scheme as at 31 March 2008 demonstrated the scheme to be 91 per cent funded. Based on this valuation, deficit funding amounts designed to eliminate the actuarial deficit over a seven year period were made from July 2009 of £7.3 million per annum. Since the valuation date, there has been deterioration in the funding level. During 2010, the Group agreed to pay additional funding of £5.8 million per annum from October 2010 until the conclusion of the next formal valuation, or until the funding level reaches 90 per cent, whichever is the earlier. The IAS 19 deficit of the Scottish Amicable Pension Scheme at 31 December 2010 of £146 million (2009: £139 million) has been allocated approximately 50 per cent to the PAC with-profits fund and 50 per cent to the shareholders' fund.

The valuation of the M&G pension scheme as at 31 December 2008 was finalised in January 2010 and demonstrated the scheme to be 76 per cent funded. Based on this valuation, deficit funding amounts designed to eliminate the actuarial deficit over a five year period have been made from January 2010 of £14.1 million per annum for the first two years and £9.3 million per annum for the subsequent three years. The IAS 19 deficit of the M&G pension scheme on an economic basis at 31 December 2010 was £27 million (2009: £36 million) and is wholly attributable to shareholders.

The next triennial valuations for the PSPS, Scottish Amicable and M&G pension schemes are scheduled to take place as at 5 April 2011, 31 March 2011 and 31 December 2011, respectively.

**(i)** Assumptions

The actuarial assumptions used in determining benefit obligations and the net periodic benefit costs for the years ended 31 December were as follows:

| | **2010** | 2009 |
|---|---|---|
| | % | % |
| Discount rate* | **5.45** | 5.8 |
| Rate of increase in salaries | **5.55** | 5.7 |
| Rate of inflation | **3.55** | 3.7 |
| Rate of increase of pensions in payment for inflation: | | |
| Guaranteed (maximum 5%) | **3.55** | 3.7 |
| Guaranteed (maximum 2.5%)** | **2.5** | 2.5 |
| Discretionary** | **2.5** | 2.5 |
| Expected returns on plan assets | **5.9** | 4.5 |

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

** The rates of 2.5 per cent are those for PSPS. Assumed rates of increase of pensions in payments for inflation for all other schemes are 3.55 per cent in 2010 (2009: 3.7 per cent).

The calculations are based on current actuarially calculated mortality estimates with a specific allowance made for future improvements in mortality. The 2010 specific allowance is in line with a custom calibration of the 2009 mortality model from the Continuous Mortality Investigation Bureau of the Institute and Faculty of Actuaries ("CMI").

The tables used for PSPS immediate annuities in payment at 31 December 2010 were:

Male: 108.6 per cent PNMA 00 with improvements in line with a custom calibration of the CMI's 2009 mortality model, with a long-term mortality improvement rate of 1.75 per cent per annum; and
Female: 103.4 per cent PNFA 00 with improvements in line with a custom calibration of the CMI's 2009 mortality model, with a long-term mortality improvement rate of 1.00 per cent per annum.

In July 2010, the UK Government announced plans to use the Consumer Price Index (CPI) in place of the Retail Price Index (RPI) in its determination of the statutory minimum pension increases for private sector occupational pension schemes. In December 2010, the Government published the statutory revaluation order for 2011 which confirms the change to use CPI. In addition, the Government has also published in December 2010 a consultation paper which sets out the Government's views on the impact of the switch from RPI to CPI will have on the private sector occupational pension schemes. The consultation period closed on 2 March 2011.

For the Group's UK defined benefit schemes, the pensions in deferment and/or pensions in payment for certain tranches of these schemes are subject to statutory increases in accordance with the schemes' rules and may therefore be affected by the Government's decision to change the indexation from RPI to CPI. Other tranches, where RPI is specified in the scheme rules, are unaffected.

The above has no impact on the results for the year ended 31 December 2010. The impact of this change, if and when made, will be recognised in a future period. Using the underlying information as at 31 December 2010 the estimated effect of such a change would give rise to an accounting benefit of approximately £30 million to the Group's operating profit based on longer-term investment returns and profit attributable to shareholders before tax and £20 million to shareholders' equity.

**(ii)** Estimated pension scheme deficit – economic basis

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

| | 2010 | | | | |
|---|---|---|---|---|---|
| | | (Charge) credit to income statement | | | |
| | **Surplus (deficit) in scheme at 1 January 2010** | **Operating results (based on longer-term investment returns)** (note a) | **Actuarial and other gains and losses** (note b) | **Contributions paid** | **Surplus (deficit) in scheme at 31 Dec 2010** (note c) |
| | £m | £m | £m | £m | £m |
| **All schemes** | | | | | |
| **Underlying position (without the effect of IFRIC 14)** | | | | | |
| Surplus (deficit) | **338** | **(7)** | **(109)** | **90** | **312** |
| Less: amount attributable to PAC with-profits fund | **(285)** | **(11)** | **71** | **(39)** | **(264)** |
| Shareholders' share: | | | | | |
| Gross of tax surplus (deficit) | **53** | **(18)** | **(38)** | **51** | **48** |
| Related tax | **(15)** | **5** | **11** | **(14)** | **(13)** |
| Net of shareholders' tax | **38** | **(13)** | **(27)** | **37** | **35** |
| **Effect of IFRIC 14** | | | | | |
| Surplus (deficit) | **(588)** | **(38)** | **94** | **-** | **(532)** |
| Less: amount attributable to PAC with-profits fund | **407** | **29** | **(66)** | **-** | **370** |
| Shareholders' share: | | | | | |
| Gross of tax surplus (deficit) | **(181)** | **(9)** | **28** | **-** | **(162)** |
| Related tax | **51** | **2** | **(9)** | **-** | **44** |
| Net of shareholders' tax | **(130)** | **(7)** | **19** | **-** | **(118)** |
| **With the effect of IFRIC 14** | | | | | |
| Surplus (deficit) | **(250)** | **(45)** | **(15)** | **90** | **(220)** |
| Less: amount attributable to PAC with-profits fund | **122** | **18** | **5** | **(39)** | **106** |
| Shareholders' share: | | | | | |
| Gross of tax surplus (deficit) | **(128)** | **(27)** | **(10)** | **51** | **(114)** |
| Related tax | **36** | **7** | **2** | **(14)** | **31** |
| Net of shareholders' tax | **(92)** | **(20)** | **(8)** | **37** | **(83)** |

**Notes**

(a) The components of the (charge) credit to operating results (gross of allocation of the share attributable to the PAC with-profits fund) are as follows:

| | 2010 | 2009 |
|---|---|---|
| | £m | £m |
| Service cost | **(38)** | (34) |
| Finance (expense) income: | | |
| Interest on pension scheme liabilities | **(294)** | (277) |
| Expected return on assets | **325** | 240 |
| Total charge without the effect IFRIC 14 | **(7)** | (71) |
| Effect of IFRIC 14 for pension schemes | **(38)** | 23 |
| Total charge after the effect of IFRIC 14 | **(45)** | (48) |

The net charge to operating profit (gross of the share attributable to the PAC with-profits fund) of £45 million (2009: £48 million) is made up of a charge of £27 million (2009: £29 million) relating to PSPS and a charge of £18 million (2009: £19 million) for other schemes. This net charge represents:

| | **2010** | 2009 |
|---|---|---|
| | £m | £m |
| Underlying IAS 19 charge for other pension schemes | **(18)** | (19) |
| Cash costs for PSPS | **(23)** | (25) |
| Unwind of discount on opening provision for deficit funding for PSPS | **(4)** | (4) |
| | **(45)** | (48) |

Consistent with the derecognition of the Company's interest in the underlying IAS 19 surplus of PSPS, the charge to operating profit on longer-term investment returns for PSPS reflects the cash cost of contributions for ongoing service of active members. In addition, the charge to the operating results also includes a charge for the unwind of discount on the opening provision for deficit funding for PSPS.

(b) The components of the credit (charge) for actuarial and other gains and losses (gross of allocation of the share attributable to the PAC with-profits fund (but for 2009 excluding the charge relating to the Taiwan agency business sold in that year)) are as follows:

| | **2010** £m | 2009 £m |
|---|---|---|
| Actual less expected return on assets | **306** | 108 |
| Losses on changes of assumptions for plan liabilities | **(411)** | (521) |
| Experience (losses) gains on liabilities | **(4)** | 76 |
| Total charge without the effect of IFRIC 14 | **(109)** | (337) |
| Effect of IFRIC 14 for pension schemes | **94** | 182 |
| Actuarial and other gains and losses after the effect of IFRIC 14 | **(15)** | (155) |

The net charge for actuarial and other gains and losses is recorded within the income statement but, within the segmental analysis of profit, the shareholders' share of actuarial and other gains and losses (i.e. net of allocation of the share to the PAC with-profits funds) is excluded from operating profit based on longer-term investment returns.

The 2010 actuarial losses of £109 million primarily reflects the effect of decrease in risk discount rates and the change in the economic assumptions underlying PSPS commutation factors partially offset by the effect of decreases in inflation rates and the excess of market returns over long-term assumption.

Consistent with the derecognition of the Company's interest in the underlying IAS 19 surplus of PSPS, the actuarial gains and losses do not include those of PSPS. In addition, as a result of applying of IFRIC 14, the Group has recognised a provision for deficit funding in respect of PSPS. The change in 2010 in relation to this provision recognised above as other gains and losses on defined benefit pension schemes was £nil (2009: £48 million).

(c) On the 'economic basis', after including the underlying assets represented by the investments in Prudential insurance policies as scheme assets, the underlying statements of financial position of the schemes at 31 December were:

| | **2010 £m** | 2009 £m |
|---|---|---|
| Equities | **825** | 1,096 |
| Bonds | **4,203** | 3,686 |
| Properties | **228** | 287 |
| Cash-like investments | **748** | 443 |
| Total value of assets | **6,004** | 5,512 |
| Present value of benefit obligations | **(5,692)** | (5,174) |
| | **312** | 338 |
| Effect of the application of IFRIC 14 for pension schemes: | | |
| Derecognition of PSPS surplus | **(485)** | (513) |
| Adjust for deficit funding for PSPS | **(47)** | (75) |
| Pre-tax deficit | **(220)** | (250) |

**(iii)** Sensitivity of the pension scheme liabilities of the PSPS, Scottish Amicable and M&G pension schemes to key variables

The table below shows the sensitivity of the underlying PSPS, Scottish Amicable and M&G pension scheme liabilities at 31 December 2010 of £4,866 million, £572 million and £254 million respectively (2009: £4,436 million, £515 million and £223 million) to changes in discount rates and inflation rates. In addition, the table below shows the sensitivity of the underlying PSPS, Scottish Amicable and M&G pension scheme liabilities at 31 December 2010 to changes to mortality rate assumptions.

**2010**

| **Assumption** | **Change in assumption** | **Impact on scheme liabilities on IAS 19 basis** | |
|---|---|---|---|
| Discount rate | Decrease by 0.2% from 5.45% to 5.25% | Increase in scheme liabilities by: | |
| | | PSPS | 3.6% |
| | | Scottish Amicable | 5.2% |
| | | M&G | 5.1% |
| Discount rate | Increase by 0.2% from 5.45% to 5.65% | Decrease in scheme liabilities by: | |
| | | PSPS | 3.5% |
| | | Scottish Amicable | 4.9% |
| | | M&G | 4.8% |
| Rate of inflation | Decrease by 0.2% from 3.55% to 3.35% with consequent reduction in salary increases | Decrease in scheme liabilities by: | |
| | | PSPS | 1.0% |
| | | Scottish Amicable | 5.0% |
| | | M&G | 4.5% |
| Mortality rate | Increase life expectancy by 1 year | Increase in scheme liabilities by: | |
| | | PSPS | 2.1% |
| | | Scottish Amicable | 2.5% |
| | | M&G | 2.9% |

**2009**

| **Assumption** | **Change in assumption** | **Impact on scheme liabilities on IAS 19 basis** | |
|---|---|---|---|
| Discount rate | Decrease by 0.2% from 5.8% to 5.6% | Increase in scheme liabilities by: | |
| | | PSPS | 3.50% |
| | | Scottish Amicable | 5.20% |
| | | M&G | 4.90% |
| Discount rate | Increase by 0.2% from 5.8% to 6.0% | Decrease in scheme liabilities by: | |
| | | PSPS | 3.20% |
| | | Scottish Amicable | 4.80% |
| | | M&G | 4.90% |
| Rate of inflation | Decrease by 0.2% from 3.7% to 3.5% with consequent reduction in salary increases | Decrease in scheme liabilities by: | |
| | | PSPS | 0.90% |
| | | Scottish Amicable | 4.90% |
| | | M&G | 4.50% |

The sensitivity of the underlying pension scheme liabilities to changes in discount, inflation and mortality rates as shown above does not directly equate to an impact on the profit or loss attributable to shareholders or shareholders' equity due to the effect of the application of IFRIC 14 on PSPS and the allocation of a share of the interest in financial position of the PSPS and Scottish Amicable schemes to the PAC with-profits fund as described above.

The sensitivity to the changes in the key variables as shown in the table above has no significant impact on the pension costs included in the Group's operating results. This is due to the pension costs charged in each of the periods presented being derived largely from market conditions at the beginning of the period. After applying IFRIC 14 and to the extent attributable to shareholders, any residual impact from the changes to these variables is reflected as actuarial gains and losses on defined benefit pension schemes within the supplementary analysis of profits. The relevance of this to each of the three UK schemes is described further below.

For PSPS, the underlying surplus of the scheme of £485 million (2009: £513 million) has not been recognised under IFRIC 14. Any change in the underlying scheme liabilities to the extent that it is not sufficient to alter PSPS into a liability in excess of the deficit funding provision will not have an impact on the Group's results and financial position. Based on the underlying financial position of PSPS as at 31 December 2010, none of the changes to the underlying scheme liabilities for the changes in the variables shown in the table above have had an impact on the Group's 2010 results and financial position.

In the event that a change in the PSPS scheme liabilities results in a deficit position for the scheme which is recognisable, the deficit recognised affects the Group's results and financial position only to the extent of the amounts attributable to shareholder operations. The amounts attributable to the PAC with-profits fund are absorbed by the liability for unallocated surplus and have no direct effect on the profit or loss attributable to shareholders or shareholders' equity.

The deficit of the Scottish Amicable pension scheme has been allocated 50 per cent to the PAC with-profits fund and 50 per cent to the shareholders. Accordingly, half of the changes to the scheme liabilities for the changes in the variables shown in the table above would have had an impact on the Group’s shareholder results and financial position. The M&G pension scheme is wholly attributable to shareholders.

## Z Policyholder liabilities

### Analysis of movement in policyholder liabilities and unallocated surplus of with-profits funds

Group insurance operations

| | Insurance operations | | | |
|---|---|---|---|---|
| | UK | US | Asia | Total |
| | £m | £m | £m | £m |
| At 1 January 2009 | 115,961 | 45,361 | 21,069 | 182,391 |
| Premiums | 6,867 | 9,177 | 3,807 | 19,851 |
| Surrenders | (3,971) | (3,255) | (1,201) | (8,427) |
| Maturities/Deaths | (7,239) | (733) | (342) | (8,314) |
| Net flows | (4,343) | 5,189 | 2,264 | 3,110 |
| Shareholders transfers post tax | (202) | - | (20) | (222) |
| Change in reserving basis in Malaysia | - | - | (63) | (63) |
| Assumption changes (shareholder-backed business) | (46) | - | (4) | (50) |
| Investment-related items and other movements | 14,118 | 2,986 | 4,242 | 21,346 |
| Foreign exchange translation differences | 707 | (5,225) | (2,069) | (6,587) |
| Disposal of Taiwan agency business | - | - | (3,508) | (3,508) |
| At 31 December 2009 / 1 January 2010 | **126,195** | **48,311** | **21,911** | **196,417** |
| *Comprising:* | | | | |
| *- Policyholder liabilities* | **116,229** | **48,311** | **21,858** | **186,398** |
| *- Unallocated surplus of with-profits funds* | **9,966** | **-** | **53** | **10,019** |
| Premiums | **7,890** | **11,735** | **4,308** | **23,933** |
| Surrenders | **(3,779)** | **(3,598)** | **(2,241)** | **(9,618)** |
| Maturities/Deaths | **(7,303)** | **(769)** | **(498)** | **(8,570)** |
| Net flows | **(3,192)** | **7,368** | **1,569** | **5,745** |
| Shareholders transfers post tax | **(223)** | **-** | **(24)** | **(247)** |
| Assumption changes (shareholder-backed business) | **(46)** | **-** | **19** | **(27)** |
| Investment-related items and other movements | **13,218** | **3,464** | **2,216** | **18,898** |
| Foreign exchange translation differences | **(208)** | **1,380** | **2,081** | **3,253** |
| Dilution of holding in PruHealth | **(27)** | **-** | **-** | **(27)** |
| Acquisition of UOB Life Assurance Limited | **-** | **-** | **968** | **968** |
| As at 31 December 2010 | **135,717** | **60,523** | **28,740** | **224,980** |
| *Comprising:* | | | | |
| *- Policyholder liabilities* | **125,530** | **60,523** | **28,674** | **214,727** |
| *- Unallocated surplus of with-profits funds* | **10,187** | **-** | **66** | **10,253** |
| Average policyholder liability balances* | | | | |
| 2010 | **120,880** | **54,417** | **25,750** | **201,047** |
| 2009 | 111,969 | 46,837 | 19,630 | 178,436 |

* Adjusted for acquisition and disposals in the period and excluding unallocated surplus of with-profits funds.

The items above represent the amount attributable to changes in policyholder liabilities and unallocated surplus of with-profits funds as a result of each of the components listed.

Premiums, surrenders and maturities / deaths represent the amounts impacting policyholder liabilities and may not represent the total cash paid / received (for example, premiums are net of any deductions to cover acquisition costs and claims represents the policyholder liabilities released).

UK insurance operations

A reconciliation of the total policyholder liabilities and unallocated surplus of with-profits funds of UK insurance operations is as follows:

| | | Other shareholder-backed funds and subsidiaries | | |
|---|---|---|---|---|
| | **SAIF and PAC with-profits sub-fund** | **Unit-linked liabilities** | **Annuity and other long-term business** | **Total** |
| | £m | £m | £m | £m |
| At 1 January 2009 | 82,108 | 16,318 | 17,535 | 115,961 |
| Premiums | 3,271 | 1,860 | 1,736 | 6,867 |
| Surrenders | (2,394) | (1,535) | (42) | (3,971) |
| Maturities/Deaths | (5,147) | (670) | (1,422) | (7,239) |
| Net flows (note (a)) | (4,270) | (345) | 272 | (4,343) |
| Shareholders transfers post tax | (202) | - | - | (202) |
| Switches | (270) | 270 | - | - |
| Assumption changes (shareholder-backed business) (note (c)) | - | - | (46) | (46) |
| Investment-related items and other movements (note (b)) | 9,365 | 2,849 | 1,904 | 14,118 |
| Foreign exchange translation differences | 764 | (57) | – | 707 |
| At 31 December 2009 / 1 January 2010 | **87,495** | **19,035** | **19,665** | **126,195** |
| *Comprising:* | | | | |
| *- Policyholder liabilities* | **77,529** | **19,035** | **19,665** | **116,229** |
| *- Unallocated surplus of with-profits funds* | **9,966** | **-** | **-** | **9,966** |
| Premiums | **3,311** | **2,301** | **2,278** | **7,890** |
| Surrenders | **(2,453)** | **(1,272)** | **(54)** | **(3,779)** |
| Maturities/Deaths | **(5,079)** | **(726)** | **(1,498)** | **(7,303)** |
| Net flows (note (a)) | **(4,221)** | **303** | **726** | **(3,192)** |
| Shareholders transfers post tax | **(223)** | **-** | **-** | **(223)** |
| Switches | **(236)** | **236** | **-** | **-** |
| Assumption changes (shareholder-backed business) (note (c)) | **-** | **-** | **(46)** | **(46)** |
| Investment-related items and other movements (note (b)) | **9,165** | **2,097** | **1,956** | **13,218** |
| Dilution of holding in PruHealth | **-** | **-** | **(27)** | **(27)** |
| Foreign exchange translation differences | **(207)** | **-** | **(1)** | **(208)** |
| At 31 December 2010 | **91,773** | **21,671** | **22,273** | **135,717** |
| *Comprising:* | | | | |
| *- Policyholder liabilities* | **81,586** | **21,671** | **22,273** | **125,530** |
| *- Unallocated surplus of with-profits funds* | **10,187** | **-** | **-** | **10,187** |
| Average policyholder liability balances* | | | | |
| 2010 | **79,558** | **20,353** | **20,969** | **120,880** |
| 2009 | 75,692 | 17,677 | 18,600 | 111,969 |

*Excluding the unallocated surplus of the with-profits funds and as adjusted for corporate transactions in the period.

**Notes**

(a) Net flows of negative £3,192 million have improved from negative £4,343 million in 2009, principally as a result of increased premiums due to the bulk annuity transaction in 2010 and improved unit-linked flows.

(b) Investment-related items and other movements of £13,218 million across fund types reflected the continued strong performance of UK equity markets in 2010, as well as the continued increase in value of debt securities.

(c) Assumption changes principally represent the net impact of changes to the mortality assumptions and expense assumptions.

US insurance operations

| | Variable annuity separate account liabilities £m | Fixed annuity, GIC and other business £m | Total £m |
|---|---|---|---|
| At 1 January 2009 | 14,538 | 30,823 | 45,361 |
| Premiums | 4,667 | 4,510 | 9,177 |
| Surrenders | (882) | (2,373) | (3,255) |
| Maturities/Deaths | (199) | (534) | (733) |
| Net flows (note (b)) | 3,586 | 1,603 | 5,189 |
| Transfers from general to separate account | 984 | (984) | – |
| Investment-related items and other movements (note (c)) | 3,368 | (382) | 2,986 |
| Foreign exchange translation differences (note (a)) | (1,837) | (3,388) | (5,225) |
| At 31 December 2009 / 1 January 2010 | **20,639** | **27,672** | **48,311** |
| Premiums | **7,420** | **4,315** | **11,735** |
| Surrenders | **(1,403)** | **(2,195)** | **(3,598)** |
| Maturities/Deaths | **(259)** | **(510)** | **(769)** |
| Net flows (note (b)) | **5,758** | **1,610** | **7,368** |
| Transfers from general to separate account | **1,411** | **(1,411)** | **-** |
| Investment-related items and other movements (note (c)) | **2,875** | **589** | **3,464** |
| Foreign exchange translation differences (note (a)) | **520** | **860** | **1,380** |
| At 31 December 2010 | **31,203** | **29,320** | **60,523** |
| Average policyholder liability balances | | | |
| 2010 | **25,921** | **28,496** | **54,417** |
| 2009 | 17,589 | 29,248 | 46,837 |

**Notes**

(a) Movements in the year have been translated at an average rate of 1.55 (2009: 1.57). The closing balance has been translated at closing rate of 1.57 (2009: 1.61). Differences upon retranslation are included in foreign exchange translation differences of £1,380 million (2009: £5,525 million).

(b) Net flows for the year were £7,368 million compared with £5,189 million in 2009, driven largely by increased new business volumes for the variable annuity business.

(c) Positive investment-related items and other movements in variable annuity separate account liabilities of £2,875 million in 2010 and £3,368 million in 2009 represent increases in the US equity market during the respective periods. Fixed annuity, GIC and other business investment and other movements primarily reflects the movement in the valuation of the product guarantees and interest credited to policyholder accounts. In 2010, interest credited exceeded the small reduction in the guarantee valuation to give an overall increase in liabilities. In 2009, there was a more significant fall in the valuation of guarantees.

Asian insurance operations

| | With-profits business £m | Unit-linked liabilities £m | Other £m | Total £m |
|---|---|---|---|---|
| At 1 January 2009 | 8,094 | 7,220 | 5,755 | 21,069 |
| Premiums | | | | |
| New business (note (b)) | 46 | 643 | 517 | 1,206 |
| In-force | 777 | 1,223 | 601 | 2,601 |
| | 823 | 1,866 | 1,118 | 3,807 |
| Surrenders | (361) | (666) | (174) | (1,201) |
| Maturities/Deaths | (253) | (19) | (70) | (342) |
| Net flows | 209 | 1,181 | 874 | 2,264 |
| Shareholders transfers post tax | (20) | – | – | (20) |
| Change in reserving basis in Malaysia (note (d)) | – | (9) | (54) | (63) |
| Change in other reserving basis | – | – | (4) | (4) |
| Investment-related items and other movements (note (e)) | 1,431 | 2,661 | 150 | 4,242 |
| Foreign exchange translation differences (note (a)) | (853) | (612) | (604) | (2,069) |
| Disposal of Taiwan agency business (note (f)) | – | (724) | (2,784) | (3,508) |
| At 31 December 2009 / At 1 January 2010 | **8,861** | **9,717** | **3,333** | **21,911** |
| *Comprising:* | | | | |
| *- Policyholder liabilities* | **8,808** | **9,717** | **3,333** | **21,858** |
| *- Unallocated surplus of with-profits funds* | **53** | **–** | **–** | **53** |
| Premiums | | | | |
| New business (note (b)) | **141** | **1,072** | **452** | **1,665** |
| In-force | **897** | **1,130** | **616** | **2,643** |
| | **1,038** | **2,202** | **1,068** | **4,308** |
| Surrenders(note (c)) | **(441)** | **(1,572)** | **(228)** | **(2,241)** |
| Maturities/Deaths | **(326)** | **(40)** | **(132)** | **(498)** |
| Net flows (note (b)) | **271** | **590** | **708** | **1,569** |
| Shareholders transfers post tax | **(24)** | **-** | **-** | **(24)** |
| Change in other reserving basis | **-** | **-** | **19** | **19** |
| Investment-related items and other movements (note (e)) | **693** | **1,405** | **118** | **2,216** |
| Foreign exchange translation differences (note (a)) | **719** | **1,009** | **353** | **2,081** |
| Acquisition of UOB Life Assurance Limited (note (g)) | **504** | **3** | **461** | **968** |
| At 31 December 2010 | **11,024** | **12,724** | **4,992** | **28,740** |
| *Comprising:* | | | | |
| *- Policyholder liabilities* | **10,958** | **12,724** | **4,992** | **28,674** |
| *- Unallocated surplus of with-profits funds* | **66** | **–** | **–** | **66** |
| Average policyholder liability balances* | | | | |
| 2010 | **10,135** | **11,222** | **4,393** | **25,750** |
| 2009 | 8,371 | 8,107 | 3,152 | 19,630 |

*Adjusted for transactions in the period and excluding the unallocated surplus of with-profits funds.

**Notes**

(a) Movements in the year have been translated at the average exchange rate for the year ended 31 December 2010. The closing balance has been translated at the closing spot rates as at 31 December 2010. Differences upon retranslation are included in foreign exchange translation differences of positive £2,081 million in 2010 (2009: negative £2,069 million).

(b) The increase in policyholder liabilities due to new business premium for the unit-linked business was predominantly driven by an increase in sales during the year of individual linked products.

(c) Following the recovery of the stock markets in Asia in late 2009 and 2010, policyholders in Asia took the opportunity to capitalise on the increased value of their unit-linked policies through withdrawals, principally in Indonesia, Malaysia, and India.
The depressed state of the investment markets in late 2008 and 2009 resulted in both the number of, and average value of, withdrawals of investment related products decreasing.

(d) The change in reserving basis in Malaysia of £63 million reflects the change made following the adoption of a risk based capital (RBC) approach to the local regulatory reporting in that country.

(e) The positive investment related items and other movements in 2010 for with-profits (£693 million) and unit-linked business (£1,405 million) are mainly driven from Asian equity market gains in the period.

(f) The disposal of Taiwan agency business reflects the liabilities transferred at the date of disposal.

(g) The acquisition of UOB Life Assurance Limited reflects the liabilities acquired at the date of acquisition.

Duration of policyholder liabilities

| | 2010 | | | | 2009 | | | |
|---|---|---|---|---|---|---|---|---|
| | **UK insurance operations** (note (i)) | **US insurance operations** (note (ii)) | **Asian insurance operations** (note (iii)) | **Total** | UK insurance operations | US insurance operations | Asian insurance operations | Total |
| | £m | £m | £m | £m | £m | £m | £m | £m |
| Insurance contract liabilities | **84,152** | **58,641** | **28,498** | **171,291** | 77,655 | 46,346 | 21,712 | 145,713 |
| Investment contract liabilities with discretionary participation features | **25,613** | **-** | **119** | **25,732** | 24,780 | – | 100 | 24,880 |
| Investment contract liabilities without discretionary participation features | **15,765** | **1,882** | **57** | **17,704** | 13,794 | 1,965 | 46 | 15,805 |
| | **125,530** | **60,523** | **28,674** | **214,727** | 116,229 | 48,311 | 21,858 | 186,398 |

The tables above show the carrying value of the policyholder liabilities. Separately, the Group uses cash flow projections of expected benefit payments as part of the determination of the value of in-force business when preparing EEV basis results. The tables in the accompanying notes below show the maturity profile of the cash flows used for that purpose for insurance contracts, as defined by IFRS, i.e. those containing significant insurance risk, and investment contracts, which do not.
The cash flow projections of expected benefit payments used in the maturity profile tables are from value of in-force business and exclude the value of future new business, including vesting of internal pension contracts. The maturity tables have been prepared on a discounted basis.

**Notes**
(i) UK insurance operations

| | **With-profits business** | | | **Annuity business (insurance contracts)** | | | **Other** | | | **Total** |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Insurance contracts** | **Investment contracts** | **Total** | **PAL** | **PRIL** | **Total** | **Insurance contracts** | **Investments contracts** | **Total** | |
| **2010** | £m | £m | £m | £m | £m | £m | £m | £m | £m | £m |
| Policyholders liabilities | **43,691** | **25,613** | **69,304** | **12,282** | **16,442** | **28,724** | **11,737** | **15,765** | **27,502** | **125,530** |
| | **%** | **%** | **%** | **%** | **%** | **%** | **%** | **%** | **%** | **%** |
| Expected maturity: | | | | | | | | | | |
| 0 to 5 years | **46** | **31** | **40** | **32** | **29** | **30** | **35** | **29** | **32** | **36** |
| 5 to 10 years | **25** | **25** | **25** | **25** | **23** | **24** | **26** | **21** | **23** | **24** |
| 10 to 15 years | **13** | **19** | **16** | **18** | **17** | **18** | **18** | **20** | **19** | **17** |
| 15 to 20 years | **7** | **14** | **10** | **12** | **13** | **12** | **10** | **11** | **11** | **11** |
| 20 to 25 years | **4** | **8** | **6** | **7** | **8** | **8** | **6** | **8** | **7** | **7** |
| over 25 years | **5** | **3** | **3** | **6** | **10** | **8** | **5** | **11** | **8** | **5** |

| | **With-profits business** | | | **Annuity business (Insurance contracts)** | | | **Other** | | | **Total** |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Insurance contracts** | **Investment contracts** | **Total** | **PAL** | **PRIL** | **Total** | **Insurance contracts** | **Investments contracts** | **Total** | |
| **2009** | £m | £m | £m | £m | £m | £m | £m | £m | £m | £m |
| Policyholders liabilities | **40,780** | **24,780** | **65,560** | **11,969** | **14,292** | **26,261** | **10,614** | **13,794** | **24,408** | **116,229** |
| | **%** | **%** | **%** | **%** | **%** | **%** | **%** | **%** | **%** | **%** |
| Expected maturity: | | | | | | | | | | |
| 0 to 5 years | 50 | 29 | 41 | 32 | 31 | 32 | 34 | 35 | 35 | 38 |
| 5 to 10 years | 26 | 25 | 26 | 25 | 23 | 24 | 25 | 22 | 23 | 25 |
| 10 to 15 years | 13 | 19 | 15 | 18 | 17 | 17 | 18 | 19 | 18 | 16 |
| 15 to 20 years | 6 | 14 | 9 | 11 | 12 | 12 | 11 | 11 | 11 | 10 |
| 20 to 25 years | 3 | 9 | 6 | 7 | 8 | 7 | 7 | 6 | 6 | 6 |
| over 25 years | 2 | 4 | 3 | 7 | 9 | 8 | 5 | 7 | 7 | 5 |

**Notes**
(a) The cash flow projections of expected benefit payments used in the maturity profile table above are from value of in-force business and exclude the value of future new business, including vesting of internal pension contracts.
(b) Benefit payments do not reflect the pattern of bonuses and shareholder transfers in respect of the with-profits business.
(c) Investment contracts under Other comprise certain unit-linked and similar contracts accounted for under IAS 39 and IAS 18.
(d) For business with no maturity term included within the contracts, for example with-profits investment bonds such as Prudence Bonds, an assumption is made as to likely duration based on prior experience.

(ii) US insurance operations

| | 2010 | | | 2009 | | |
|---|---|---|---|---|---|---|
| | **Fixed annuity and other business (including GICs and similar contracts)** | **Variable annuity** | **Total** | Fixed annuity and other business (including GICs and similar contracts) | Variable annuity | Total |
| | £m | £m | £m | £m | £m | £m |
| **Policyholder liabilities** | **29,320** | **31,203** | **60,523** | 27,672 | 20,639 | 48,311 |
| | % | % | % | % | % | % |
| **Expected maturity:** | | | | | | |
| **0 to 5 years** | **50** | **50** | **50** | 52 | 50 | 51 |
| **5 to 10 years** | **27** | **29** | **28** | 27 | 28 | 28 |
| **10 to 15 years** | **11** | **12** | **12** | 10 | 12 | 11 |
| **15 to 20 years** | **5** | **6** | **5** | 5 | 6 | 5 |
| **20 to 25 years** | **3** | **2** | **3** | 3 | 2 | 2 |
| **Over 25 years** | **4** | **1** | **2** | 3 | 2 | 3 |

(iii) Asian insurance operations

| | **2010** | 2009 |
|---|---|---|
| | £m | £m |
| Policyholder liabilities | **28,674** | 21,858 |
| Expected maturity: | **%** | % |
| 0 to 5 years | **24** | 24 |
| 5 to 10 years | **20** | 21 |
| 10 to 15 years | **15** | 15 |
| 15 to 20 years | **12** | 12 |
| 20 to 25 years | **10** | 9 |
| Over 25 years | **19** | 19 |

## AA Sensitivity analysis

### Sensitivity of IFRS basis profit or loss and equity to market and other risks

*Overview of risks by business unit*
The financial and insurance assets and liabilities attaching to the Group's life assurance business are, to varying degrees, subject to market and insurance risk and other changes of experience assumptions that may have a material effect on IFRS basis profit or loss and equity.

Market risk is the risk that the fair value or future cash flows of a financial instrument or, in the case of liabilities of insurance contracts, their carrying value will fluctuate because of changes in market prices. Market risk comprises three types of risk, namely:

- Currency risk: due to changes in foreign exchange rates;
- interest rate risk: due to changes in market interest rates; and
- other price risk: due to fluctuations in market prices (other than those arising from interest rate risk or currency risk).

Policyholder liabilities relating to the Group's life assurance businesses are also sensitive to the effects of other changes in experience, or expected future experience, such as for mortality, other insurance risk and lapse risk.
In addition, the profitability of the Group's life assurance businesses and asset management business, is indirectly affected by the performance of the assets covering policyholder liabilities and related capital.

Three key points are to be noted, namely:

- The Group's with-profit and unit-linked funds absorb most market risk attaching to the funds' investments. Except for second order effects, for example on asset management fees and shareholders' share of cost of bonuses for with-profits business, shareholder results are not directly affected by market value movements on the assets of these funds;
- the Group's shareholder results are most sensitive to market risks for assets of the shareholder-backed business; and
- the main exposures of the Group's IFRS basis results to market risk for life assurance operations on investments of the shareholder-backed business are for debt securities.

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

| Type of business | Market and credit risk: Investments/derivatives | Market and credit risk: Liabilities/unallocated surplus | Other exposure | Insurance and lapse risk |
|---|---|---|---|---|
| *UK insurance operations* | | | | |
| With-profits business (including Prudential Annuities Limited) | Net neutral direct exposure | (Indirect exposure only) | Investment performance subject to smoothing through declared bonuses | Persistency risk to future shareholder transfers |
| SAIF sub-fund | Net neutral direct exposure | (Indirect exposure only) | Asset management fees earned by M&G | |
| Unit-linked business | Net neutral direct exposure | (Indirect exposure only) | Investment performance through asset management fees | Persistency risk |
| Shareholder-backed annuity business | Asset/liability mismatch risk<br>Credit risk<br>Interest rate risk for assets in excess of liabilities i.e. representing shareholder capital | | | Mortality experience and assumptions for longevity |
| *US insurance operations* | | | | |
| All business | Currency risk | | | Persistency risk |
| Variable annuity business | Net effect of market risk arising from incidence of guarantee features and variability of asset management fees offset by derivative hedging programme | | | |
| Fixed indexed annuity business | Derivative hedge programme to the extent not fully hedged against liability and fund performance | Incidence of equity participation features | | |
| Fixed indexed annuities, Fixed annuities and GIC business | Credit risk<br>Interest rate risk<br>These risks are reflected in volatile profit or loss and shareholders' equity for derivative value movements and impairment losses, and, in addition, for shareholders' equity for value movements on fixed income securities classified as 'available for sale' under IAS 39 | | Spread difference between earned rate and rate credited to policyholders | Lapse risk but the effects of extreme events are mitigated by the use of swaption contracts |
| *Asian insurance operations* | | | | |
| All business | Currency risk | | | Mortality and morbidity risk<br>Persistency risk |
| With-profits business | Net neutral direct exposure | (Indirect exposure only) | Investment performance subject to smoothing through declared bonuses | |
| Unit-linked business | Net neutral direct exposure | (Indirect exposure only) | Investment performance through asset management fees | |
| Non-participating business | Interest rate and price risk | Long-term interest rates | | |

*IFRS shareholder results – Exposures for market and other risk*

Key Group exposures

The IFRS operating profit based on longer-term investment returns for UK insurance operations has high potential sensitivity for changes to longevity assumptions affecting the carrying value of liabilities to policyholders for shareholder-backed annuity business. In addition, at the total IFRS profit level the result is sensitive to temporary value movements on assets backing IFRS equity.

For Jackson at the level of operating profit based on longer-term investment returns, the results are sensitive to market conditions to the extent of income earned on spread-based products not mitigated by the interest derivative programmes and second order equity-based exposure in respect of variable annuity asset management fees. Further information is given below under the US operations section of market and credit risk.

Jackson's derivative programme is used to substantially mitigate equity market risk attaching to its equity-based products and interest rate risk associated with its spread-based products. Movements in interest rates and credit spreads materially affect the carrying value of derivatives which are used to manage the liabilities to policyholders and backing investment assets of fixed annuity and other general account business. Combined with the use of US GAAP measurement (as grandfathered under IFRS 4) for the asset and liabilities for the insurance contract liabilities, which is largely insensitive to current period market movements, the Jackson total profit (i.e. including short-term fluctuations in investment returns) is very sensitive to market movements. In addition to these effects the Jackson IFRS equity is sensitive to the impact of interest rate and credit spread movements on the value of fixed income securities. Movements in unrealised appreciation on these securities are included as movement in equity (i.e. outside the income statement).

For Asian operations, the operating profit based on longer-term investment returns is mainly affected by the impact of market levels on unit-linked business persistency, and other insurance risk.

At the total IFRS profit level the Asian result is affected by short-term value movements on the asset portfolio for non-linked shareholder-backed business.

M&G profits are affected primarily by movements in the growth in funds under management and by the effect any impairment on the loan book and fair value movements on debt securities held by Prudential Capital.

**Market and credit risk**
*UK insurance operations*
With-profits business

- With-profits business
  Shareholder results of UK with-profits business are sensitive to market risk only through the indirect effect of investment performance on declared policyholder bonuses.
  The investment assets of the PAC with-profits fund are subject to market risk. However, changes in their carrying value, net of related changes to asset-share liabilities of with-profit contracts, affect the level of unallocated surplus of the fund. As unallocated surplus is accounted for as a liability under IFRS, movements in its value do not affect shareholders' profit or equity.
  The shareholder results of the UK with-profits fund correspond to the shareholders' share of the cost of bonuses declared on the with-profits business. This currently corresponds to one-ninth of the cost of bonuses declared.
  Investment performance is a key driver of bonuses, and hence the shareholders' share of cost of bonuses. Due to the 'smoothed' basis of bonus declaration the sensitivity to investment performance in a single year is low. However, over multiple periods it is important.

- Prudential Annuities Limited (PAL)
  PAL's business is not with-profits, it writes annuity business. However, as PAL is owned by the PAC with-profits sub-fund, changes in the carrying value of PAL's assets and liabilities are reflected in the liability for unallocated surplus which as described above, do not affect shareholder results.

- Scottish Amicable Insurance Fund (SAIF)
  SAIF is a ring-fenced fund in which, apart from asset management fees, shareholders have no interest. Accordingly, the Group's IFRS profit and equity are insensitive to the direct effects of market risk attaching to SAIF's assets and liabilities.

Shareholder-backed business
The factors that may significantly affect the IFRS results of UK shareholder-backed business are the mortality experience and assumptions and credit risk attaching to the annuity business of Prudential Retirement Income Limited and the PAC non-profit sub-fund.

- Prudential Retirement Income Limited (PRIL)
  The assets covering PRIL's liabilities are principally debt securities and other investments that are held to match the expected duration and payment characteristics of the policyholder liabilities. These liabilities are valued for IFRS reporting purposes by applying discount rates that reflect the market rates of return attaching to the covering assets.
  Except to the extent of any asset/liability duration mismatch which is reviewed regularly, and exposure to credit risk, the sensitivity of the Group's results to market risk for movements in the carrying value of PRIL's liabilities and covering assets is broadly neutral on a net basis.
  The main market risk sensitivity for PRIL arises from interest rate risk on the debt securities which substantially represent IFRS equity. This equity comprises the net assets held within the long-term fund of the company that cover regulatory

basis liabilities that are not recognised for IFRS reporting purposes, for example contingency reserves, and shareholder capital held outside the long-term fund.
The principal items affecting the IFRS results for PRIL are mortality experience and assumptions and credit risk.

- PAC non-profit sub-fund
  The PAC non-profit sub-fund principally comprises annuity business previously written by Scottish Amicable Life, credit life, unit-linked and other non-participating business.
  The financial assets covering the liabilities for those types of business are subject to market risk. However, for the annuity business the same considerations as described above for PRIL apply, whilst the liabilities of the unit-linked business change in line with the matching linked assets. Other liabilities of the PAC non-profit sub-fund are broadly insensitive to market risk.

- Other shareholder-backed unit-linked business
  Due to the matching of policyholder liabilities to attaching asset value movements the UK unit-linked business is not directly affected by market or credit risk. The principal factor affecting the IFRS results is investment performance through asset management fees.

*US insurance operations*
Jackson
The IFRS basis results of Jackson are highly sensitive to market risk on the assets covering liabilities other than variable annuity business segregated in the separate accounts.

Invested assets covering liabilities (other than the separate accounts) and related capital comprise principally debt securities classified as available-for-sale. Value movements for these securities are reflected as movements in shareholders' equity through the statement of comprehensive income. Other invested assets and derivatives are carried at fair value with the value movements reflected in the income statement.

By contrast, the IFRS insurance liabilities for business written by Jackson, by the application of grandfathered GAAP under IFRS 4, are measured on US GAAP bases which with the exception of certain items covered by the equity hedging programme, are generally insensitive to temporary changes in market conditions or the short-term returns on the attaching asset portfolios.

These differences in carrying value of debt securities, other invested assets, derivatives and insurance liabilities give rise to potentially significant volatility in the IFRS income statement and shareholders' equity. As with other shareholder-backed business the profit or loss for Jackson is presented by distinguishing the result for the year between an operating result based on longer-term investment returns and short-term fluctuations in investment returns. In this way the most significant direct effect of market changes that have taken place to the Jackson result are separately identified.

Excluding these short-term effects, the factors that most significantly affect the Jackson IFRS operating result based on long-term investment returns are:

- Variable annuity business –effect of market risk arising from the variability of asset management fees
- Fixed annuity business – the spread differential between the earned rate and the rate credited to policyholders; and
- Fixed index annuity business – the spread differential between the earned rate and the rate credited to policyholders.

In addition, the total profit for Jackson is affected by the level of impairment losses on the debt securities portfolio, net effect of market risk arising from the incidence and valuation of guarantee features, guaranteed benefit payments and equity index participation features, offset by variability of benefit related fees and equity derivative hedging performance, short-term value movements on derivatives held to manage the fixed annuity and other general account business, and other temporary value movements on portfolio investments classified as fair value through profit and loss.

The Group has amended its presentation of operating profit for its US insurance operations to remove the net equity hedge accounting effect and include it in short-term fluctuations as explained further in note C. Following this change the operating profit based on longer-term investment returns of the US insurance operations of £833 million for 2010 (2009: £618 million) excludes £367 million (2009: £159 million) negative net equity hedge accounting effects, net of related change to amortisation of deferred acquisition costs. The presentation of results for 2009 has been amended accordingly.

Following this change the US insurance operating profit of £833 million for 2010 excludes the market related impacts comprised of £367 million of net equity hedging losses, net of related change to amortisation of deferred acquisition costs (2009: losses of £159 million), representing the movement in fair value of free standing equity derivatives and the movement in the accounting value of Jackson's liabilities for variable and fixed index annuity guarantees, for which a significant proportion are not fair valued, together with the associated fees and claims included in reserves. These net amounts are highly variable and not representative of underlying performance based on longer-term investment returns and have therefore been included in short-term fluctuations. The presentation of results for 2009 has been amended accordingly.

*Asian insurance operations*
For Asian with-profits business the same features apply as described above for UK with-profits business. Similarly, as for other parts of the Group, for unit-linked business the main factor affecting IFRS basis results is investment performance through asset management fees.

The sensitivity of the IFRS basis results of the Group's Asian operations to market risk is primarily restricted to the non-participating business.

This sensitivity is primarily reflected through the volatility of asset returns coupled with the fact that the accounting carrying value of liabilities to policyholders are only partially sensitive to changed market conditions. As for UK shareholder-backed operations and Jackson, the IFRS profit is distinguished in the Group's segmental analysis so as to distinguish operating profits based on longer-term investment return and short-term fluctuations in investment returns.

**Insurance and lapse risk**
The features described above cover the main sensitivities of IFRS profit and loss and equity for market, insurance and credit risk. Lapse and longevity risk may also be a key determination of IFRS basis results with variable impacts.

In the UK, adverse persistency experience can affect the level of profitability from with-profits and unit-linked business. For with-profits business in any given year, the amount represented by the shareholders' share of cost of bonus may only be marginally affected. However, altered persistency trends may affect future expected shareholder transfers.

By contrast, Group IFRS operating profit is particularly sensitive to longevity outlook that results in changes of assumption for the UK shareholder-backed annuity business.

Jackson is sensitive to lapse risk. However, Jackson uses swaption derivatives to ameliorate the effect of a sharp rise in interest rates, which would be the most likely cause of a sudden change in policyholder behaviour.

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

*Impact of diversification on risk exposure*
The Group enjoys significant diversification benefits. This arises because not all risk scenarios will happen at the same time and across all geographic regions. The Group tests the sensitivities of results to different correlation factors such as:

Correlation across geographic regions
- Financial risk factors
- Non-financial risk factors.

Correlation across risk factors
- Longevity risk
- Expenses
- Persistency
- Other risks.

The effect of Group diversification is to significantly reduce the aggregate standalone volatility risk to IFRS operating profit based on longer-term investment returns. The effect is almost wholly explained by the correlations across risk types, in particular longevity risk.

**(i)** UK insurance operations

The risks to which the IFRS basis results of the UK insurance operations are sensitive are asset/liability matching, mortality experience and payment assumptions for shareholder-backed annuity business. Further details are described below.

*With-profits business*
SAIF
Shareholders have no interest in the profits of SAIF but are entitled to the asset management fees paid on the assets of the fund.

With-profits sub-fund business
For with-profits business (including non-participating business of PAL which is owned by the WPSF) adjustments to liabilities and any related tax effects are recognised in the income statement. However, except for any impact on the annual declaration of bonuses, shareholders' profit for with-profits business is unaffected. This is because IFRS basis profits for with-profits business, which are determined on the same basis as on preceding UK GAAP, solely reflect one-ninth of the cost of bonuses declared for the year.

The main factors that influence the determination of bonus rates are the return on the investments of the fund, the effect of inflation, taxation, the expenses of the fund chargeable to policyholders and the degree to which investment returns are smoothed. Mortality and other insurance risk are relatively minor factors.

Unallocated surplus represents the excess of assets over policyholder liabilities of the fund. As unallocated surplus of the WPSF is recorded as a liability, movements in its value do not affect shareholders' profits or equity.

The level of unallocated surplus is particularly sensitive to the level of investment returns on the portion of the life fund assets that represents the surplus.

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

- The extent to which the duration of the assets held closely matches the expected duration of the liabilities under the contracts. Assuming close matching, the impact of short-term asset value movements as a result of interest rate movements will broadly offset changes in the value of liabilities caused by movements in valuation rates of interest;
- Actual versus expected default rates on assets held;
- The difference between long-term rates of return on corporate bonds and risk-free rates;
- The variance between actual and expected mortality experience;
- The extent to which expected future mortality experience gives rise to changes in the measurement of liabilities; and
- Changes in renewal expense levels.

A decrease in assumed mortality rates of one per cent would decrease gross profits by approximately £53 million (2009: £44 million). A decrease in credit default assumptions of five basis points would increase gross profits by £119 million (2009: £91 million). A decrease in renewal expenses (excluding asset management expenses) of five per cent would increase gross profits by £23 million (2009: £17 million). The effect on profits would be approximately symmetrical for changes in assumptions that are directionally opposite to those explained above.

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

Profits from unit-linked and similar contracts primarily arise from the excess of charges to policyholders, for management of assets under the Company's stewardship, over expenses incurred. The former is most sensitive to the net accretion of funds under management as a function of new business and lapse and timing of death. The accounting impact of the latter is dependent upon the amortisation of acquisition costs in line with the emergence of margins (for insurance contracts) and amortisation in line with service provision (for the investment management component of investment contracts). By virtue of the design features of most of the contracts which provide low levels of mortality cover, the profits are relatively insensitive to changes in mortality experience.

*Shareholder exposure to interest rate risk and other market risk*
By virtue of the fund structure, product features and basis of accounting, the policyholder liabilities of the UK insurance operations are, except for pension annuity business, not generally exposed to interest rate risk. For pension annuity business, liabilities are exposed to fair value interest rate risk. However, the net exposure to the PAC WPSF (for PAL) and shareholders (for liabilities of PRIL and the non-profit sub-fund) is very substantially ameliorated by virtue of the close matching of assets with appropriate duration. The level of matching from period to period can vary depending on management actions and economic factors so it is possible for a degree of mis-matching profits or losses to arise.

The close matching by the Group of assets of appropriate duration to annuity liabilities is based on maintaining economic and regulatory capital. The measurement of liabilities under capital reporting requirements and IFRS is not the same with contingency reserves and some other margins for prudence within the assumptions required under the FSA regulatory solvency basis not included for IFRS reporting purposes. As a result IFRS equity is higher than regulatory capital and therefore more sensitive to interest rate risk.

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

| | **2010 £m** | | | | 2009 £m | | | |
|---|---|---|---|---|---|---|---|---|
| | **A decrease of 2%** | **A decrease of 1%** | **An increase of 1%** | **An increase of 2%** | A decrease of 2% | A decrease of 1% | An increase of 1% | An increase of 2% |
| Carrying value of debt securities and derivatives | **6,547** | **2,938** | **(2,434)** | **(4,481)** | 5,372 | 2,422 | (2,020) | (3,731) |
| Policyholder liabilities | **(5,977)** | **(2,723)** | **2,109** | **3,929** | (5,125) | (2,304) | 1,905 | 3,498 |
| Related deferred tax effects | **(154)** | **(58)** | **88** | **149** | (69) | (33) | 32 | 65 |
| Net sensitivity of profit after tax and shareholders' equity | **416** | **157** | **(237)** | **(403)** | 178 | 85 | (83) | (168) |

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

| | 2010 £m | | 2009 £m | |
|---|---|---|---|---|
| | **A decrease of 20%** | **A decrease of 10%** | A decrease of 20% | A decrease of 10% |
| Pre-tax profit | **(302)** | **(151)** | (292) | (146) |
| Related deferred tax effects | **82** | **41** | 82 | 41 |
| Net sensitivity of profit after tax and shareholders' equity | **(220)** | **(110)** | (210) | (105) |

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

In the equity risk sensitivity analysis given above, the Group has considered the impact of an instantaneous 20 per cent fall in equity markets. If equity markets were to fall by more than 20 per cent, the Group believes that this would not be an instantaneous fall but rather this would be expected to occur over a period of time during which the Group would be able to put in place mitigating management actions.

**(ii)** US insurance operations

*Currency fluctuations*

Consistent with the Group's accounting policies, the profits of the Group's US operations are translated at average exchange rates and shareholders' equity at the closing rate for the reporting period. For 2010, the rates were US$1.55 (2009: US$1.57) and US$1.57 (2009: US$1.61) to £1 sterling, respectively. A 10 per cent increase or decrease in these rates would reduce or increase profit (loss) before tax attributable to shareholders, profit (loss) for the year and shareholders' equity attributable to US insurance operations respectively as follows:

| | **A 10% increase in exchange rates** | | **A 10% decrease in exchange rates** | |
|---|---|---|---|---|
| | **2010 £m** | 2009 £m | **2010 £m** | 2009 £m |
| Profit (loss) before tax attributable to shareholders (note (i)) | **(41)** | (44) | 50 | 54 |
| Profit (loss) for the year | **(31)** | (54) | 37 | 65 |
| Shareholders' equity attributable to US insurance operations | **(347)** | (274) | 424 | 335 |

**Note**

(i) Sensitivity on profit (loss) before tax i.e. aggregate of the operating profit based on longer-term investment returns and short-term fluctuations.

*Other sensitivities*

The principal determinants of variations in operating profit based on longer-term returns are:

- Growth in the size of assets under management covering the liabilities for the contracts in force;
- Variations in fees and other income, offset by variations in market value adjustment payments and, where necessary, strengthening of liabilities;
- Spread returns for the difference between investment returns and rates credited to policyholders; and
- Amortisation of deferred acquisition costs.

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

A detailed analysis of actual experience is measured by internally developed mortality and persistency studies. For variable annuity business, the key assumption is the expected long-term level of equity market returns, which for 2010 and 2009 was 8.4 per cent per annum implemented using a mean reversion methodology. These returns affect the level of future expected profits through their effects on the fee income and the required level of provision for guaranteed minimum death benefit claims. The mean reversion methodology dampens the impact of equity market movements during a particular year, but does not fully eliminate the effects of movements in the equity markets.

In addition, the mean reversion methodology includes both a cap and a floor that determine the maximum impact that the methodology may have. The projected rates of return are capped at no more than 15 per cent for each of the next five years.

Except to the extent of mortality experience, which primarily affects profits through variations in claim payments and GMDB reserves, the profits of Jackson are relatively insensitive to changes in insurance risk.

*Exposure to equity risk*

Variable annuity contracts related

Jackson issues variable contracts through its separate accounts for which investment income and investment gains and losses accrue to, and investment risk is borne by, the contract holder (traditional variable annuities). It also issues variable annuity and life contracts through separate accounts where it contractually guarantees to the contract holder (variable contracts with guarantees) either a) return of no less than deposits made to the contract adjusted for any partial withdrawals, b) total deposits made to the contract adjusted for any partial withdrawals plus a minimum return, or c) the highest contract value on a specified anniversary date adjusted for any withdrawals following the contract anniversary. These guarantees include benefits that are payable in the event of death (GMDB), annuitisation (GMIB), at specified dates during the accumulation period (GMWB) or at the end of a specified period (GMAB).

At 31 December 2010 and 2009, Jackson had variable annuity contracts with guarantees, for which the net amount at risk ("NAR") is generally the amount of guaranteed benefit in excess of current account value, as follows:

**31 December 2010**

| | **Minimum return** | **Account value** £m | **Net amount at risk** £m | **Weighted average attained age** | **Period until expected annuitisation** |
|---|---|---|---|---|---|
| Return of net deposits plus a minimum return | | | | | |
| GMDB | **0-6%** | **25,540** | **2,106** | **64.0 years** | |
| GMWB - Premium only | **0%** | **2,742** | **149** | | |
| GMWB - For life | **0-5%**** | **1,996** | **415*** | | |
| GMAB - Premium only | **0%** | **48** | **1** | | |
| Highest specified anniversary account value minus withdrawals post-anniversary | | | | | |
| GMDB | | **3,742** | **466** | **63.3 years** | |
| GMWB - Highest anniversary only | | **2,010** | **343** | | |
| GMWB - For life | | **852** | **196*** | | |
| Combination net deposits plus minimum return, highest specified anniversary account value minus withdrawals post-anniversary | | | | | |
| GMDB | **0-6%** | **1,768** | **311** | **65.7 years** | |
| GMIB | **0-6%** | **1,933** | **418** | | **5.1 years** |
| GMWB -For life | **0-8%**** | **15,025** | **672*** | | |

**31 December 2009**

| | Minimum return | Account value £m | Net amount at risk £m | Weighted average attained age | Period until expected annuitisation |
|---|---|---|---|---|---|
| Return of net deposits plus a minimum return | | | | | |
| GMDB | 0-6% | 16,915 | 2,834 | 63.8 years | |
| GMWB - Premium only | 0% | 2,505 | 277 | | |
| GMWB - For life | 0-5%** | 1,240 | 471* | | |
| GMAB - Premium only | 0% | 27 | 2 | | |
| Highest specified anniversary account value minus withdrawals post-anniversary | | | | | |
| GMDB | | 2,933 | 691 | 62.8 years | |
| GMWB - Highest anniversary only | | 1,694 | 496 | | |
| GMWB - For life | | 811 | 258* | | |
| Combination net deposits plus minimum return, highest specified anniversary account value minus withdrawals post-anniversary | | | | | |
| GMDB | 0-6% | 1,307 | 384 | 65.1 years | |
| GMIB | 0-6% | 1,815 | 488 | | 5.9 years |
| GMWB -For life | 0-7%** | 6,934 | 568* | | |

* The NAR for GMWB "For life" has been estimated as the present value of future expected benefit payments remaining after the amount of the "not for life " guaranteed benefit is zero.

**Ranges shown based on simple interest. The upper limits of five per cent, seven per cent and eight per cent simple interest are approximately equal to 4.1 per cent, 5.5 per cent and six per cent respectively, on a compound interest basis over a typical 10-year bonus period.

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

| | 2010 | 2009 |
|---|---|---|
| | £m | £m |
| Mutual fund type: | | |
| Equity | **23,841** | 15,477 |
| Bond | **3,417** | 2,340 |
| Balanced | **3,345** | 2,186 |
| Money market | **451** | 522 |
| Total | **31,054** | 20,525 |

Jackson is exposed to equity risk through the options embedded in the fixed indexed liabilities and GMDB and GMWB guarantees included in certain VA benefits as illustrated above. This risk is managed using a comprehensive equity hedging programme to minimise the risk of a significant economic impact as a result of increases or decreases in equity market levels while taking advantage of naturally offsetting exposures in Jackson's operations. Jackson purchases external futures and options that hedge the risks inherent in these products, while also considering the impact of rising and falling separate account fees.

As a result of this hedging programme, if the equity markets were to increase further in the future, Jackson's free-standing derivatives would decrease in value. However, over time, this movement would be broadly offset by increased separate account fees and reserve decreases, net of the related changes to amortisation of deferred acquisition costs. Due to the nature of the free-standing and embedded derivatives, this hedge, while highly effective on an economic basis, may not completely mute the immediate impact of equity market movements as the free-standing derivatives reset immediately while the hedged liabilities reset more slowly and fees are recognised prospectively. The opposite impacts would be observed if the equity markets were to decrease.

At 31 December 2010 based on the hedges in place at that time, it is estimated that an immediate decrease in the equity markets of 10 per cent would result in an accounting benefit, net of related DAC amortisation, before tax of up to £100 million (2009: £60 million), excluding the impact on future separate account fees. After related deferred tax there would have been an estimated increase in shareholders' equity at 31 December 2010 of up to £60 million (2009: £40 million). An immediate decrease in the equity markets of 20 per cent is estimated to result in an accounting benefit, net of related DAC amortisation, before tax of up to £170 million (2009: £110 million), excluding the impact on future separate account fees. After related deferred tax there would have been an estimated increase in shareholders' equity at 31 December 2010 of up to £110 million (2009: £80 million). An immediate increase in the equity markets of 10 and 20 per cent is estimated to result in an approximately equal and opposite estimated effect on profit and shareholders' equity as that disclosed above for a decrease.

The actual impact on financial results would vary contingent upon the volume of new product sales and lapses, changes to the derivative portfolio, correlation of market returns and various other factors including volatility, interest rates and elapsed time.

### Other exposure to equity risk

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

A range of reasonably possible movements in the value of equity securities, partnerships in investment pools and other financial derivatives have been applied to Jackson's holdings at 31 December 2010 and 31 December 2009. The table below shows the sensitivity to a 10 and 20 per cent fall in value and the impact that this would have on pre-tax profit, net of related changes in amortisation of DAC, profit after tax and shareholders' equity.

| | **2010 £m** | | 2009 £m | |
|---|---|---|---|---|
| | **A decrease of 20%** | **A decrease of 10%** | A decrease of 20% | A decrease of 10% |
| Pre-tax profit, net of related changes in amortisation of DAC | **(143)** | **(72)** | (117) | (58) |
| Related deferred tax effects | **50** | **25** | 41 | 20 |
| Net sensitivity of profit after tax and shareholders' equity | **(93)** | **(47)** | (76) | (38) |

A 10 or 20 per cent increase in their value is estimated to have an approximately equal and opposite effect on profit and shareholders' equity to the sensitivities shown above.

In the equity risk sensitivity analysis given above, the Group has considered the impact of an instantaneous 20 per cent fall in equity markets. If equity markets were to fall by more than 20 per cent, the Group believes that this would not be an instantaneous fall but rather this would be expected to occur over a period of time during which the Group would be able to put in place mitigating management actions.

*Exposure to interest rate risk*

Notwithstanding the market risk exposure previously described, except in the circumstances of interest rate scenarios where the guarantee rates included in contract terms are higher than crediting rates that can be supported from assets held to cover liabilities, the accounting measurement of fixed annuity liabilities of Jackson products is not generally sensitive to interest rate risk. This position derives from the nature of the products and the US GAAP (as 'grandfathered' under IFRS 4) basis of measurement. The GMWB features attaching to variable annuity business (other than "for-life") represents embedded derivatives which are fair valued and so will be sensitive to changes in interest rate.

Debt securities and related derivatives are marked to fair value. Value movements on derivatives, again net of related changes to amortisation of DAC and deferred tax, are recorded within profit and loss. Fair value movements on debt securities, net of related changes to amortisation of DAC and deferred tax, are recorded within other comprehensive income. The estimated sensitivity of these items and policyholder liabilities to a one per cent and two per cent decrease and increase in interest rates at 31 December 2010 and 2009 is as follows:

| | 2010 £m | | | | 2009 £m | | | |
|---|---|---|---|---|---|---|---|---|
| | **A 2% decrease** | **A 1% decrease** | **A 1% increase** | **A 2% increase** | A 2% decrease | A 1% decrease | A 1% increase | A 2% increase |
| Profit and loss | | | | | | | | |
| Direct effect | | | | | | | | |
| Derivatives value change | **842** | **363** | **(277)** | **(529)** | (319) | (148) | 159 | 370 |
| Policyholder liabilities | **(547)** | **(243)** | **219** | **416** | (418) | (185) | 170 | 334 |
| Related effect on amortisation of DAC | **47** | **23** | **(34)** | **(63)** | 364 | 162 | (156) | (328) |
| Pre-tax profit effect | | | | | | | | |
| Operating profit based on longer-term investment returns | **579** | **245** | **(181)** | **(345)** | (144) | (62) | 56 | 109 |
| Short-term fluctuations in investment returns | **(237)** | **(102)** | **89** | **169** | (229) | (109) | 117 | 267 |
| | **342** | **143** | **(92)** | **(176)** | (373) | (171) | 173 | 376 |
| Related effect on charge for deferred tax | **(120)** | **(50)** | **32** | **62** | 131 | 60 | (60) | (131) |
| Net profit effect | **222** | **93** | **(60)** | **(114)** | (242) | (111) | 113 | 245 |
| Other comprehensive income | | | | | | | | |
| Direct effect on carrying value of debt securities | **2,663** | **1,454** | **(1,454)** | **(2,663)** | 2,183 | 1,179 | (1,179) | (2,183) |
| Related effect on amortisation of DAC | **(1,174)** | **(641)** | **641** | **1,174** | (764) | (413) | 413 | 764 |
| Related effect on movement in deferred tax | **(521)** | **(285)** | **285** | **521** | (497) | (268) | 268 | 497 |
| Net effect | **968** | **528** | **(528)** | **(968)** | 922 | 498 | (498) | (922) |
| Total net effect on IFRS equity | **1,190** | **621** | **(588)** | **(1,082)** | 680 | 387 | (385) | (677) |

**(iii)** Asian insurance operations

*Sensitivity of IFRS basis profit and equity to market and other risks*

Currency translation

Consistent with the Group's accounting policies, the profits of the Asian insurance operations are translated at average exchange rates and shareholders' equity at the closing rate for the reporting period.

A 10 per cent increase or decrease in these rates would have reduced or increased profit before tax attributable to shareholders, profit for the year and shareholders' equity, excluding goodwill, attributable to Asian operations respectively as follows:

| | **A 10% increase in exchange rates** | | **A 10% decrease in exchange rates** | |
|---|---|---|---|---|
| | **2010** £m | 2009 £m | **2010** £m | 2009 £m |
| Profit before tax attributable to shareholders (note(i)) | **(65)** | (40) | **80** | 49 |
| Profit for the year | **(58)** | (35) | **71** | 43 |
| Shareholders' equity, excluding goodwill, attributable to Asian operations | **(193)** | (129) | **236** | 158 |

**Note**

(i) Sensitivity on profit before tax i.e. aggregate of the operating profit based on longer-term investment returns, short-term fluctuations in investment returns, and actuarial gains and losses on defined benefit pension schemes but excluding the loss on sale and results for Taiwan agency business.

*Other risks*

With-profits business

Similar principles to those explained for UK with-profits business apply to profit emergence for the Asian with-profits business.

Correspondingly, the profit emergence reflects bonus declaration and is relatively insensitive to period by period fluctuations in insurance risk or interest rate movements.

*Unit-linked business*
As for the UK insurance operations, the profits and shareholders' equity related to the Asian operations is primarily driven by charges related to invested funds. For the Asian operations, substantially all of the contracts are classified as insurance contracts under IFRS 4, i.e. containing significant insurance risk. The sensitivity of profits and equity to changes in insurance risk is minor and, to interest rate risk, not material.

*Other business*
Interest rate risk
Asian operations offer a range of insurance and investment products, predominately with-profits and non-participating term, whole life endowment and unit-linked. Excluding with-profit and unit-linked business, the results of the Asian business are sensitive to the vagaries of routine movements in interest rates.

For the purposes of analysing sensitivity to variations in interest rates, it has been determined for the majority of territories that a movement of 1 per cent in the 10 year government bond rate can be considered reasonably possible. At 31 December 2010, 10 year government bond rates vary from territory to territory and range from 1.1 per cent to 12.25 per cent (2009: 1.3 per cent to 11.45 per cent). Exception to this arises in Japan and Taiwan where reasonably possible interest rate movements have been determined as 0.5 per cent (2009: Japan and Taiwan 0.5 per cent). These reasonably possible changes would have the following impact:

| | **2010 £m** | 2009 £m |
|---|---|---|
| | **A decrease of 1% (note (i))** | A decrease of 1% (note (i)) |
| Pre-tax profit | **110** | 91 |
| Related deferred tax (where applicable) | **(41)** | (22) |
| Net effect on profit and equity | **69** | 69 |

**Note**
(i) One per cent sensitivity has been used in all territories (except Japan and Taiwan (0.5 per cent)) (2009: Japan and Taiwan 0.5 per cent) The pre-tax impacts, if they arose, would mostly be recorded within the category short-term fluctuations in investments returns in the Group's segmental analysis of profit before tax.

At 31 December 2010, an increase in the rates of one per cent (Japan and Taiwan (0.5 per cent) (2009: one per cent except Japan and Taiwan 0.5 per cent) is estimated to have the effect of decreasing pre-tax profit by £112 million (2009: £109 million). After adjusting these results for deferred tax the reasonable possible effect on shareholders' equity is a decrease of £82 million (2009: £83 million).

*Equity price risk*
The non-linked shareholder business has limited exposure to equity and property investment (£515 million at 31 December 2010). Generally changes in equity and property investment values are not automatically matched by investments in policyholder liabilities. However for the Vietnam business, to the extent that equity investment appreciation is realised through sales of securities then policyholders' liabilities are adjusted to the extent that policyholders participate.

The estimated sensitivity to a 10 and 20 per cent change in equity and property prices for shareholder-backed Asian other business, which would be reflected in the short-term fluctuation component of the Group's segmental analysis of profit before tax, at 31 December 2010 and 2009 would be as follows:

| | **2010 £m** | | 2009 £m | |
|---|---|---|---|---|
| | **A decrease of 20%** | **A decrease of 10%** | A decrease of 20% | A decrease of 10% |
| Pre-tax profit | **(103)** | **(52)** | (58) | (29) |
| Related deferred tax (where applicable) | **10** | **5** | 8 | 4 |
| Net effect on profit and equity | **(93)** | **(47)** | (50) | (25) |

A 10 or 20 per cent increase in their value is estimated to have an approximately equal and opposite effect on profit and shareholders' equity to the sensitivities shown above.

In the equity risk sensitivity analysis given above the Group has considered the impact of an instantaneous 20 per cent fall in equity markets. If equity markets were to fall by more than 20 per cent, the Group believes that this would not be an instantaneous fall but rather this would be expected to occur over a period of time during which the Group would be able to put in place mitigating management actions.

*Insurance risk*
Many of the territories in Asia are exposed to mortality/morbidity risk and provision is made within IFRS policyholder liabilities on a prudent regulatory basis to cover the potential exposure. If these prudent assumptions were strengthened by five per cent (estimated at one in ten year shock) then it is estimated that post tax IFRS profit would be impacted by approximately £21 million (2009: £9 million) (with a corresponding change to IFRS shareholders' equity). Mortality/morbidity has a symmetrical effect on portfolio and so a weakening of mortality/morbidity assumptions would have an approximately equal and opposite similar impact.

**(iv)** Asset management operations

*Currency translation*
Consistent with the Group's accounting policies, the profits of the Asia and PPM America asset management operations are translated at average exchange rates and shareholders' equity at the closing rate for the reporting period. The rates for the most significant operations are given in note VII.

A 10 per cent increase in the relevant exchange rates would have reduced reported profit before tax attributable to shareholders and shareholders' equity, excluding goodwill attributable to Asia and PPM America asset management operations, by £9 million (2009: £5 million) and £28 million (2009: £23 million) respectively.

*Other sensitivities to other financial risks for asset management operations*
The principal sensitivities to other financial risk of asset management operations are credit risk on the bridging loan portfolio of the Prudential Capital operation and the indirect effect of changes to market values of funds under management. Due to the nature of the asset management operations there is limited direct sensitivity to movements in interest rates. Total debt securities held at 31 December 2010 by asset management operations were £1,574 million (2009: £1,164 million), the majority of which are held by the Prudential Capital operation. Debt securities held by M&G and Prudential Capital are in general variable rate bonds and so market value is limited in sensitivity to interest rate movements and consequently any change in interest rates would not have a material impact on profit or shareholder's equity. Asset management operations do not hold significant investments in property or equities.

## AB Share capital, share premium and own shares

| | **2010** | | |
|---|---|---|---|
| | **Number of ordinary shares** | **Share capital** | **Share premium** |
| | | **£m** | **£m** |
| Issued shares of 5p each fully paid: | | | |
| At 1 January 2010 | **2,532,227,471** | **127** | **1,843** |
| Shares issued under share option schemes | **2,455,227** | **-** | **13** |
| Shares issued in lieu of cash dividends | **10,911,808** | **-** | **62** |
| Reserve movements in respect of shares issued in lieu of cash dividends | **-** | **-** | **(62)** |
| At 31 December 2010 | **2,545,594,506** | **127** | **1,856** |

| | 2009 | | |
|---|---|---|---|
| | Number of ordinary shares | Share capital | Share premium |
| | | £m | £m |
| Issued shares of 5p each fully paid: | | | |
| At 1 January 2009 | 2,496,947,688 | 125 | 1,840 |
| Shares issued under share option schemes | 605,721 | – | 3 |
| Shares issued in lieu of cash dividends | 34,674,062 | 2 | 136 |
| Reserve movements in respect of shares issued in lieu of cash dividends | – | – | (136) |
| At 31 December 2009 | 2,532,227,471 | 127 | 1,843 |

Amounts recorded in share capital represent the nominal value of the shares issued. The difference between the proceeds received on issue of shares, net of issue costs, and the nominal value of shares issued is credited to the share premium account. Shares issued in lieu of cash dividends are considered to take the legal form of bonus issue shares and have been accounted for as such.

At 31 December 2010, there were options outstanding under Save As You Earn schemes to subscribe for 12,802,482 (2009: 12,230,833) shares at prices ranging from 288 pence to 572 pence (2009: 266 pence to 572 pence) and exercisable by the year 2016 (2009: 2016).

The cost of own shares of £75 million as at 31 December 2010 (2009: £75 million) is deducted from retained earnings. The Company has established trusts to facilitate the delivery of shares under employee incentive plans and savings-related share option schemes. At 31 December 2010, 4.5 million (2009: 5.3 million) Prudential plc shares with a market value of £30 million (2009: £34 million) were held in such trusts. Of this total, 4.4 million (2009: 4.8 million) shares were held in trusts under employee incentive plans. In 2010, the Company purchased 5.7 million (2009: 3.4 million) shares in respect of employee incentive plans at a cost of £32 million (2009: £17 million). The maximum number of shares held in the year was 5.3 million which was at the beginning of the year.

Of the total shares held in trust 0.1 million (2009: 0.5 million) were held by a qualifying employee share ownership trust. These shares are expected to be fully distributed in the future on maturity of savings-related share option schemes.

The shares purchased each month are as follows:

| 2010 | Number of shares | Share Price Low | Share Price High | Cost |
|---|---|---|---|---|
| | | £ | £ | £ |
| January | 9,338 | 6.38 | 6.38 | 59,530 |
| February | 11,638 | 5.68 | 5.68 | 66,046 |
| March | 3,908,274 | 5.16 | 6.09 | 20,884,460 |
| April | 11,129 | 5.63 | 5.63 | 62,601 |
| May | 14,638 | 5.59 | 5.59 | 81,753 |
| June | 190,991 | 5.26 | 5.66 | 1,075,712 |
| July | 13,457 | 5.14 | 5.14 | 69,102 |
| August | 10,016 | 5.86 | 5.86 | 58,644 |
| September | 13,727 | 5.25 | 5.84 | 78,539 |
| October | 11,634 | 6.37 | 6.37 | 74,108 |
| November | 385,321 | 5.74 | 6.49 | 2,244,770 |
| December | 1,153,611 | 6.04 | 6.65 | 7,445,358 |
| **2010 Total** | 5,733,774 | | | 32,200,623 |

The shares purchased each month are as follows:

| 2009 | Number of shares | Share Price Low | Share Price High | Cost |
|---|---|---|---|---|
| | | £ | £ | £ |
| January | 19,852 | 3.83 | 3.94 | 76,575 |
| February | 19,926 | 3.52 | 3.52 | 70,140 |
| March | 1,112,209 | 2.02 | 3.50 | 3,837,968 |
| April | 22,164 | 3.38 | 3.38 | 74,859 |
| May | 32,416 | 4.45 | 6.59 | 173,242 |
| June | 26,594 | 4.44 | 7.31 | 145,230 |
| July | 342,062 | 3.86 | 4.03 | 1,374,929 |
| August | 14,059 | 4.85 | 4.85 | 68,144 |
| September | 12,435 | 5.50 | 5.50 | 68,393 |
| October | 10,332 | 6.34 | 6.34 | 65,453 |
| November | 10,576 | 6.04 | 6.04 | 63,879 |
| December | 1,739,591 | 6.06 | 6.35 | 10,941,847 |
| **2009 Total** | 3,362,216 | | | 16,960,659 |

The Group has consolidated a number of authorised investment funds where it is deemed to control these funds under IFRS. Some of these funds hold shares in Prudential plc. The total number of shares held by these funds at 31 December 2010 was 9.8 million (2009: 10.6 million) and the cost of acquiring these shares of £47 million (2009: £50 million) is included in the cost of own shares. The market value of these shares as at 31 December 2010 was £65 million (2009: £67 million).

During 2010 and 2009 respectively, these funds made 833,618 net disposals and 1,414,263 net acquisitions of Prudential shares for a net decrease of £3 million and a net increase of £3 million to book cost.

All share transactions were made on an exchange other than the Stock Exchange of Hong Kong.

The Company did not buy back any of its own shares during 2010 or 2009.

### AC Post balance sheet events

In January 2011, the Company issued US$550 million 7.75 per cent Tier 1 subordinated debt, primarily to retail investors. The proceeds, net of costs, were US$539 million and are intended to finance the repayments of the €500 million Tier 2 subordinated notes in December 2011.

## Additional Unaudited Financial Information

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

This schedule classifies the Group's pre-tax operating earnings from long-term insurance operations into the underlying drivers of those profits, using the following categories:

**(i)** **Spread income** represents the difference between net investment income (or premium income in the case of the UK annuities new business) and amounts credited to policyholder accounts. It excludes the longer-term investment return on assets in excess of those covering shareholder-backed policyholder liabilities, which has been separately disclosed as **expected return on shareholder assets**.

**(ii)** **Fee income** represents profits driven by net investment performance, being asset management fees that vary with the size of the underlying policyholder funds net of investment management expenses.

**(iii)** **With-profits** business represents the shareholders' transfer from the with-profits fund in the period.

**(iv)** **Insurance margin** primarily represents profits derived from the insurance risks of mortality, morbidity and persistency.

**(v)** **Margin on revenues** primarily represents amounts deducted from premiums to cover acquisition costs and administration expenses.

**(vi)** **Acquisition costs and administration expenses** represent expenses incurred in the period attributable to shareholders. It excludes items such as restructuring costs and Solvency II costs which are not included in the segment profit for insurance as well as items that are more appropriately included in other source of earnings lines (e.g. investment expenses are netted off investment income as part of spread income or fee income as appropriate).

**(vii)** **DAC adjustments** comprises DAC amortisation for the period, excluding amounts related to short-term fluctuations, net of costs deferred in respect of new business.

Analysis of pre-tax IFRS operating profit by source

| | **2010** | | | | |
|---|---|---|---|---|---|
| | **Asia** | **US** | **UK** | **Unallocated** | **Total** |
| | £m | £m | £m | £m | £m |
| Spread income | **70** | **692** | **251** | **-** | **1,013** |
| Fee income | **122** | **506** | **60** | **-** | **688** |
| With-profits | **32** | **-** | **310** | **-** | **342** |
| Insurance margin | **392** | **188** | **12** | **-** | **592** |
| Margin on revenues | **1,018** | **-** | **223** | **-** | **1,241** |
| Expenses | | | | | |
| Acquisition costs | **(656)** | **(851)** | **(167)** | **-** | **(1,674)** |
| Administration expenses | **(467)** | **(344)** | **(113)** | **-** | **(924)** |
| DAC adjustments | **2** | **517** | **(1)** | **-** | **518** |
| Expected return on shareholder assets | **19** | **125** | **98** | **-** | **242** |
| Long-term business operating profit | **532** | **833** | **673** | **-** | **2,038** |
| Asset management operating profit | **72** | **22** | **284** | **-** | **378** |
| GI commission | **-** | **-** | **46** | **-** | **46** |
| Other income and expenditure* | **-** | **-** | **-** | **(521)** | **(521)** |
| Total operating profit based on longer-term investment returns | **604** | **855** | **1,003** | **(521)** | **1,941** |

| | 2009 (i) | | | | |
|---|---|---|---|---|---|
| | Asia | US | UK | Unallocated | Total |
| | £m | £m | £m | £m | £m |
| Spread income | 31 | 524 | 198 | - | 753 |
| Fee income | 80 | 324 | 54 | - | 458 |
| With-profits | 29 | - | 281 | - | 310 |
| Insurance margin | 253 | 154 | 41 | - | 448 |
| Margin on revenues | 766 | - | 275 | - | 1,041 |
| Expenses | | | | | |
| Acquisition costs | (605) | (690) | (192) | - | (1,487) |
| Administration expenses | (382) | (259) | (173) | - | (814) |
| DAC adjustments | 150 | 467 | (3) | - | 614 |
| Expected return on shareholder assets | 25 | 98 | 125 | - | 248 |
| Non-recurrent release of reserves for Malaysia life operations | 63 | - | - | - | 63 |
| Long-term business operating profit | 410 | 618 | 606 | - | 1,634 |
| Asset management operating profit | 55 | 4 | 238 | - | 297 |
| GI commission | - | - | 51 | - | 51 |
| Other income and expenditure* | - | - | - | (418) | (418) |
| Total operating profit based on longer-term investment returns | 465 | 622 | 895 | (418) | 1,564 |

**Including restructuring and Solvency II implementation costs.*

| | 2008 [(i)] | | | | |
|---|---|---|---|---|---|
| | Asia | US | UK | Unallocated | Total |
| | £m | £m | £m | £m | £m |
| Spread income | 38 | 461 | 35 | - | 534 |
| Fee income | 54 | 292 | 57 | - | 403 |
| With-profits | 30 | - | 395 | - | 425 |
| Insurance margin | 198 | 161 | (12) | - | 347 |
| Margin on revenues | 672 | - | 314 | - | 986 |
| Expenses | | | | | |
| Acquisition costs | (619) | (451) | (172) | - | (1,242) |
| Administration expenses | (331) | (217) | (212) | - | (760) |
| DAC adjustments | 173 | - | 32 | - | 205 |
| Expected return on shareholder assets | 16 | 89 | 108 | - | 213 |
| Long-term business operating profit | 231 | 335 | 545 | - | 1,111 |
| Asset management operating profit | 52 | 7 | 286 | - | 345 |
| GI commission | - | - | 44 | - | 44 |
| Other income and expenditure* | - | - | - | (288) | (288) |
| Total operating profit based on longer-term investment returns | 283 | 342 | 875 | (288) | 1,212 |

**Including restructuring and Solvency II implementation costs.*

(i) During 2010 the Group amended its presentation of operating profit for its US insurance operations to remove the net equity hedge accounting effect associated with Jackson's variable annuity and fixed index annuity products, which are now classified in the Group's supplementary analysis of profit before tax attributable to shareholders as part of short term fluctuations in investment returns. 2009 and 2008 operating profit have been amended accordingly and so net equity hedge effects of £159 million negative and £71 million positive have been removed from the previously stated operating profits of £1,405 million and £1,283 million to give a restated value of £1,564 million and £1,212 million, respectively.

## Margin analysis of long-term insurance business

The following analysis expresses certain of the Group's sources of operating profit as a margin of policyholder liabilities or other suitable driver. Details of the Group's average policyholder liability balances are given in note Z.

**Total**

| | **2010** | | | 2009 | | | 2008 | | |
|---|---|---|---|---|---|---|---|---|---|
| Long-term business | **Profit** £m | **Average Liability** £m | **Margin** bps | Profit £m | Average Liability £m | Margin bps | Profit £m | Average Liability £m | Margin bps |
| Spread income | **1,013** | **53,858** | **188** | 753 | 51,000 | 148 | 534 | 44,281 | 121 |
| Fee income | **688** | **57,496** | **120** | 458 | 43,373 | 106 | 403 | 38,850 | 104 |
| With-profits | **342** | **89,693** | **38** | 310 | 84,063 | 37 | 425 | 89,075 | 48 |
| Insurance margin | **592** | | | 448 | | | 347 | | |
| Margin on revenues | **1,241** | | | 1,041 | | | 986 | | |
| Expenses | | | | | | | | | |
| Acquisition costs* | **(1,674)** | **3,492** | **(48%)** | (1,487) | 2,896 | (51%) | (1,242) | 2,879 | (43%) |
| Administration expenses | **(924)** | **111,354** | **(83)** | (814) | 94,373 | (86) | (760) | 83,131 | (91) |
| DAC adjustments | **518** | | | 614 | | | 205 | | |
| Expected return on shareholder assets | **242** | | | 248 | | | 213 | | |
| Non-recurrent release of reserve for Malaysia Life | **-** | | | 63 | | | - | | |
| Operating profit | **2,038** | | | 1,634 | | | 1,111 | | |

**Asia**

| | **2010** | | | 2009 | | | 2008 | | |
|---|---|---|---|---|---|---|---|---|---|
| Long-term business | **Profit** £m | **Average Liability** £m | **Margin** bps | Profit £m | Average Liability £m | Margin bps | Profit £m | Average Liability £m | Margin bps |
| Spread income | **70** | **4,393** | **159** | 31 | 3,152 | 98 | 38 | 2,421 | 157 |
| Fee income | **122** | **11,222** | **109** | 80 | 8,107 | 99 | 54 | 6,419 | 84 |
| With-profits | **32** | **10,135** | **32** | 29 | 8,371 | 35 | 30 | 7,168 | 42 |
| Insurance margin | **392** | | | 253 | | | 198 | | |
| Margin on revenues | **1,018** | | | 766 | | | 672 | | |
| Expenses | | | | | | | | | |
| Acquisition costs* | **(656)** | **1,508** | **(44%)** | (605) | 1,261 | (48%) | (619) | 1,216 | (51%) |
| Administration expenses | **(467)** | **15,615** | **(299)** | (382) | 11,259 | (339) | (331) | 8,840 | (374) |
| DAC adjustments | **2** | | | 150 | | | 173 | | |
| Expected return on shareholder assets | **19** | | | 25 | | | 16 | | |
| Non-recurrent release of reserve for Malaysia Life | **-** | | | 63 | | | - | | |
| Operating profit | **532** | | | 410 | | | 231 | | |

* The ratio for acquisition costs is calculated as a percentage of APE including with-profits sales and Japan (2010: £7 million; 2009: £52 million). Acquisition costs include only those relating to shareholders.

***Analysis of Asian operating profit drivers***

- ***Spread income*** has increased from £31 million in 2009 to £70 million in 2010. This increase arises primarily as a result of improved investment return in Vietnam (where the return in 2009 was particularly low compared to both 2008 and 2010) and additional dividend income received in Japan.

- ***Fee income*** has increased both in absolute terms by £42 million and as an improvement in margin, which has increased 10bps to 109bps. This primarily relates in a change in mix towards those countries with a higher asset management fee margin (e.g.Indonesia) from countries where fees charged are lower.

- ***Insurance margin*** has increased by £139 million from £253 million in 2009 to £392 million in 2010. This reflects the continued growth in the in-force book, which has a relatively high proportion of risk-based products. 2010 includes £19 million relating to reserving changes in India and China.

- ***Margin on revenues*** has increased by £252 million reflecting the growth in the size of the portfolio and changes in country mix.

- ***Acquisition costs*** – the costs as a percentage of APE new business sales has fallen over the period 2008-2010 reflecting management's continued focus on capital management activities, such as the closure of Japan to new business in the first quarter of 2010 and changes to business and country mix. The analysis above uses shareholder acquisition costs as a proportion of total APE, excluding with profits sales from the denominator the margin would become 2010: 53 per cent, 2009: 56 per cent and 2008: 58 per cent.

- ***Administration expenses*** – margin has reduced from 339 bps in 2009 in part reflecting operational leverage benefit and a shift in mix towards countries with highly efficient business models (e.g. Indonesia).

**US**

| | **2010** | | | 2009 | | | 2008 | | |
|---|---|---|---|---|---|---|---|---|---|
| Long-term business | **Profit £m** | **Average Liability £m** | **Margin bps** | Profit £m | Average Liability £m | Margin bps | Profit £m | Average Liability £m | Margin bps |
| Spread income | **692** | **28,496** | **243** | 524 | 29,248 | 179 | 461 | 25,322 | 182 |
| Fee income | **506** | **25,921** | **195** | 324 | 17,589 | 184 | 292 | 14,783 | 198 |
| With-profits | **-** | | | - | | | - | | |
| Insurance margin | **188** | | | 154 | | | 161 | | |
| Margin on revenues | **-** | | | - | | | - | | |
| Expenses | | | | | | | | | |
| Acquisition costs | **(851)** | **1,164** | **(73%)** | (690) | 912 | (76%) | (451) | 716 | (63%) |
| Administration expenses | **(344)** | **54,417** | **(63)** | (259) | 46,837 | (55) | (217) | 40,105 | (54) |
| DAC adjustments | **517** | | | 467 | | | - | | |
| Expected return on shareholder assets | **125** | | | 98 | | | 89 | | |
| Operating profit | **833** | | | 618 | | | 335 | | |

***Analysis of US operating profit drivers:***

- ***Spread income*** benefited from the effect of transactions to more closely match the overall asset and liability duration in 2010. Excluding this effect (£108 million), spread margin in 2010 would have been 205 bps. The increase over the 2009 margin of 179 bps is due in part to decreased crediting rates on fixed annuities.

- ***Fee income*** margins are based on the average of the opening and closing separate account balances. In normal years this is expected to be a reasonable proxy for the average balances throughout the year. In 2009 separate account flows were weighted towards the end of the year artificially lowering the 2009 margin. Using an average based on end of month balances, margins show little movement between years, (2010: 200bps; 2009: 203bps; 2008: 200bps) indicating that absolute revenue amounts are growing in line with separate accounts values. Separate account values increased between 2008 and 2010 both as a result of strong sales and improving equity markets.

- ***Insurance margin*** represents operating profits from insurance risks, including variable annuity guarantees and other sundry net income. Positive net flows into variable annuity business with life contingent and other guarantees have helped improved the margin from £154 million in 2009 to £188 million in 2010.

- ***Acquisition costs*** have increased in 2010 in absolute terms compared to 2009 following an increase in sales volumes. However acquisition costs as a percentage of APE has fallen from 76 per cent in 2009 to 73 per cent in 2010 as more advisors are electing to take asset based commission, which is paid over the life of the policy based on fund value. This asset based-commission is treated as an administration expense in this analysis as opposed to a cost of acquisition, resulting in a lower acquisition cost ratio but a higher administration expenses margin.

  2008 acquisition costs as a percentage of APE sales was 63 per cent, lower than 2009 and 2010. This is primarily because sales of GICs in 2008 (APE £120 million), on which no acquisition costs are incurred, reduces the margin for that year. Excluding GIC APE sales the acquisition cost ratio for 2008 becomes 76 per cent, in line with 2009.

- ***Administration expenses*** margin has increased to 63 bps in 2010 partly as a result of higher asset based commission, which lowers acquisition costs but increases the expenses classified as administration expenses in the table above.

**UK**

| Long-term business | **2010** Profit £m | **Average Liability £m** | **Margin bps** | 2009 Profit £m | Average Liability £m | Margin bps | 2008 Profit £m | Average Liability £m | Margin bps |
|---|---|---|---|---|---|---|---|---|---|
| Spread income | **251** | **20,969** | **120** | 198 | 18,600 | 106 | 35 | 16,538 | 21 |
| Fee income | **60** | **20,353** | **29** | 54 | 17,677 | 31 | 57 | 17,648 | 32 |
| With-profits | **310** | **79,558** | **39** | 281 | 75,692 | 37 | 395 | 81,907 | 48 |
| Insurance margin | **12** | | | 41 | | | (12) | | |
| Margin on revenues | **223** | | | 275 | | | 314 | | |
| Expenses | | | | | | | | | |
| Acquisition costs* | **(167)** | **820** | **(20%)** | (192) | 723 | (27%) | (172) | 947 | (18%) |
| Administration expenses | **(113)** | **41,322** | **(27)** | (173) | 36,277 | (48) | (212) | 34,186 | (62) |
| DAC adjustments | **(1)** | | | (3) | | | 32 | | |
| Expected return on shareholder assets | **98** | | | 125 | | | 108 | | |
| Operating profit | **673** | | | 606 | | | 545 | | |

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

***<u>Analysis of UK operating profit drivers:</u>***

- ***Spread income*** has increased by £53 million to £251 million in 2010 reflecting in a higher margin of 120 bps, up from 106 bps last year. The improved margin primarily reflects the beneficial impacts of the bulk annuity deal written in 2010, improved margins on retail annuity new business and improved spread on equity release business following its closure to new business. Spread income was lower in 2008 due to lower margins on new business and the establishment of credit default and deflation reserves in that year in light of the credit crisis offset by the impact of actions to rebalance the credit portfolio.

- ***Fee income*** has increased by 11 per cent to £60 million broadly in line with the value of unit-linked liabilities following the improvement in equity markets.

- ***Margin on revenues*** represents premiums charges for expenses and other sundry net income received by the UK. Lower amounts were recorded in 2010 (£223 million) compared to 2009 (£275 million) reflecting, in part, lower premiums from shareholder-backed retail business in 2010 as compared to 2009.

- ***Insurance margin*** has fallen by £29 million to £12 million in 2010 reflecting that 2009 included a one-off benefit of £34 million in respect of a longevity swap on certain aspects of the UK's annuity back-book liabilities, which was not repeated in 2010.

- ***Acquisition costs*** as a percentage of new business sales has fallen from 27 per cent in 2009 to 20 per cent in 2010. This reflects in part the impact of the bulk annuity deal which contributed £88 million APE in the period with a relatively low level of acquisition costs, together with the closure of equity release to new business as well as on-going cost saving initiatives.

  The ratio above expresses the percentage of shareholder acquisition costs as a percentage of total APE sales. It is therefore impacted by the level of with-profit sales in the year. Acquisition costs as a percentage of shareholder-backed new business sales were 36 per cent in 2010 (49 per cent in 2009), with the most significant impact being the effect of the bulk annuity deal.

- ***Administration expenses*** have fallen by £60 million to £113 million and the ratio from 48 bps in 2009 to 27 bps in 2010. This is primarily the result of cost savings initiatives initiated by the UKIO in line with the business's stated objectives.

## 2 Asian operations – analysis of operating profit by territory

Operating profit based on longer-term investment returns for Asian operations are analysed as follows:

| | **2010** £m | 2009 £m |
|---|---|---|
| China(note (ii)) | (12) | 4 |
| Hong Kong | 51 | 48 |
| India(note (iii)) | 60 | 12 |
| Indonesia | 157 | 102 |
| Japan | (6) | (18) |
| Korea | 12 | 6 |
| Malaysia | | |
| – Underlying results | 97 | 65 |
| – Exceptional credit(note (i)) | | 63 |
| Philippines | 2 | 2 |
| Singapore | 129 | 112 |
| Taiwan bancassurance business (note (iv)) | (4) | (7) |
| Thailand | 2 | (1) |
| Vietnam | 43 | 30 |
| Other | 5 | (2) |
| **Total insurance operations** (note (v)) | 536 | 416 |
| Development expenses | (4) | (6) |
| **Total long-term business operating profit** | 532 | 410 |
| Asset management | 72 | 55 |
| **Total Asian operations** | 604 | 465 |

**Notes**

(i) For the Malaysia life business, under the basis applied previously, 2008 IFRS basis liabilities were determined on the local regulatory basis using prescribed interest rates such that a high degree of prudence resulted. As of 1 January 2009, the local regulatory basis has been replaced by the Malaysian authority's risk-based capital (RBC) framework. In the light of this development; the Company has re-measured the liabilities by reference to the method applied under the new RBC framework, which is more realistic than the previous approach, but with an overlay constraint to the method such that negative reserves derived at an individual policyholder level are not included. This change has resulted in a one-off release from liabilities at 1 January 2009 of £63 million.

(ii) China's operating loss of £12 million is after a net charge of £17 million for local reserving changes and associated impacts that have been reflected in the Group's IFRS accounts. Excluding this effect, China's underlying result is a £5 million profit.

(iii) The operating profit of £60 million from India, a joint venture, includes £36 million arising from changes that improve the reserving estimation technique. Excluding this effect, India's underlying result is a profit of £24 million.

(iv) *Sale of Taiwan agency business*
In order to facilitate comparisons of operating profit based on longer-term investment returns that reflect the Group's retained operations, the results attributable to the Taiwan agency business for which the sale process was completed in June 2009 are excluded from analysis of operating profit.

(v) *Analysis of operating profit between new and in-force business*
The result for insurance operations comprises amounts in respect of new business and business in-force as follows:

| | **2010** £m | 2009 £m |
|---|---|---|
| New business strain (excluding Japan) | **(56)** | (72) |
| Japan | **(1)** | (6) |
| New business strain (including Japan) | **(57)** | (78) |
| Business in force | **593** | 494 |
| Total | **536** | 416 |

The IFRS new business strain corresponds to approximately four per cent of new business APE premiums for 2010 (2009: approximately six per cent of new business APE).

The strain reflects the aggregate of the pre-tax regulatory basis strain to net worth after IFRS adjustments for deferral of acquisition costs and deferred income where appropriate.

## 3 Analysis of asset management operating profit based on longer-term investment returns

| | 2010 | | | | |
|---|---|---|---|---|---|
| | **M&G(i)** | **Asia(i)** | **PruCap** | **US** | **Total** |
| | £m | £m | £m | £m | £m |
| Operating income before performance-related fees | **615** | **185** | **88** | **229** | **1,117** |
| Performance-related fees | **17** | **6** | **-** | **-** | **23** |
| Operating income* | **632** | **191** | **88** | **229** | **1,140** |
| Operating expense | **(386)** | **(119)** | **(50)** | **(207)** | **(762)** |
| Operating profit based on longer-term investment returns | **246** | **72** | **38** | **22** | **378** |
| Average funds under management (FUM)** | **186.5 bn** | **47.2 bn** | | | |
| Margin based on operating income** | **34 bps** | **40 bps** | | | |
| Cost / income ratio*** | **63%** | **64%** | | | |

| | 2009 | | | | |
|---|---|---|---|---|---|
| | M&G(i) | Asia(i) | PruCap | US | Total |
| | £m | £m | £m | £m | £m |
| Operating income before performance-related fees | 470 | 157 | 89 | 183 | 899 |
| Performance-related fees | 12 | 3 | - | - | 15 |
| Operating income* | 482 | 160 | 89 | 183 | 914 |
| Operating expense | (305) | (105) | (28) | (179) | (617) |
| Operating profit based on longer-term investment returns | 177 | 55 | 61 | 4 | 297 |
| Average funds under management (FUM)** | 157.5 bn | 39.6 bn | | | |
| Margin based on operating income** | 31 bps | 40 bps | | | |
| Cost / income ratio*** | 65% | 67% | | | |

| | 2008 | | | | |
|---|---|---|---|---|---|
| | M&G(i) | Asia(i) | PruCap | US | Total |
| | £m | £m | £m | £m | £m |
| Operating income before performance-related fees | 480 | 144 | 123 | 139 | 886 |
| Performance-related fees | 43 | 3 | - | - | 46 |
| Operating income* | 523 | 147 | 123 | 139 | 932 |
| Operating expense | (295) | (95) | (65) | (132) | (587) |
| Operating profit based on longer-term investment return | 228 | 52 | 58 | 7 | 345 |
| Average funds under management (FUM)** | 154.0 bn | 36.9 bn | | | |
| Margin based on operating income** | 34 bps | 40 bps | | | |
| Cost / income ratio*** | 61% | 66% | | | |

(i) M&G and Asia asset management businesses can be further analysed as follows:

| | **M&G** | | | | | |
|---|---|---|---|---|---|---|
| | **Operating income*** | | | | | |
| | **Retail** | **Margin of FUM**** | **Institutional+** | **Margin of FUM**** | **Total** | **Margin of FUM**** |
| | £m | bps | £m | bps | £m | bps |
| **2010** | **345** | **93** | **287** | **19** | **632** | **34** |
| 2009 | 255 | 102 | 227 | 17 | 482 | 31 |
| 2008 | 243 | 122 | 280 | 21 | 523 | 34 |

| | **Asia** | | | | | |
|---|---|---|---|---|---|---|
| | **Operating income*** | | | | | |
| | **Retail** | **Margin of FUM**** | **Institutional+** | **Margin of FUM**** | **Total** | **Margin of FUM**** |
| | £m | bps | £m | bps | £m | bps |
| **2010** | **120** | **62** | **71** | **26** | **191** | **40** |
| 2009 | 98 | 60 | 62 | 27 | 160 | 40 |
| 2008 | 91 | 59 | 56 | 26 | 147 | 40 |

* Operating income is net of commissions and includes performance related fees.

** Margin represents operating income as a proportion of the related funds under management (FUM). Opening and closing internal and external funds managed by the respective entity have been used to derive the average. Any funds held by the Group's insurance operations which are managed by third parties outside of the Prudential Group are excluded from these amounts.

*** Cost/income ratio is calculated as cost as a percentage of income excluding performance-related fees.

+ Institutional includes internal funds.

## 4 Shareholders' funds summary by business unit and net asset value per share

**(i)** Shareholders' fund summary

| | **2010** £m | 2009 £m |
|---|---|---|
| **Asian operations** | | |
| Insurance operations | | |
| Net assets of operation | **1,913** | 1,382 |
| Acquired goodwill | **236** | 80 |
| Total | **2,149** | 1,462 |
| Asset management | | |
| Net assets of operation | **197** | 161 |
| Acquired goodwill | **61** | 61 |
| Total | **258** | 222 |
| Total | **2,407** | 1,684 |
| **US operations** | | |
| Jackson (net of surplus note borrowings) | **3,815** | 3,011 |
| Broker-dealer and asset management operations: | | |
| Net assets of operation | **106** | 95 |
| Acquired goodwill | **16** | 16 |
| Total | **122** | 111 |
| Total | **3,937** | 3,122 |
| **UK operations** | | |
| Insurance operations: | | |
| Long-term business operations | **2,115** | 1,902 |
| Other | **33** | 37 |
| Total | **2,148** | 1,939 |
| M&G | | |
| Net assets of operation | **254** | 173 |
| Acquired goodwill | **1,153** | 1,153 |
| Total | **1,407** | 1,326 |
| Total | **3,555** | 3,265 |
| **Other operations** | | |
| Holding company net borrowings | **(2,035)** | (1,754) |
| Shareholders' share of provision for future deficit funding of the Prudential Staff Pension Scheme (net of tax) | **(10)** | (16) |
| Other net assets (liabilities) | **177** | (30) |
| Total | **(1,868)** | (1,800) |
| **Total of all operations** | **8,031** | 6,271 |

**(ii)** Net asset value per share

| | **2010** £m | 2009 £m |
|---|---|---|
| Closing equity shareholders' funds | **8,031** | 6,271 |
| Net asset value per share attributable to equity shareholders(note (i)) | **315 p** | 248 p |

**Note**

(i) Based on the closing issued share capital as at 31 December 2010 of 2,546 million shares (2009: 2,532 million shares).

## 5 Memorandum fair value of Jackson's GMDB and GMWB liabilities

The IFRS accounting for minimum death and withdrawal benefits guarantees of the Group's US insurance operations has a mixed measurement approach.

'Not for life' Guaranteed Minimum Withdrawal Benefits (GMWB) are accounted for as 'embedded derivatives'. Where the economic characteristics and risks of embedded derivatives are not closely related to the economic characteristics and risks of the host insurance contract, and where the contract is not measured at fair value with the changes in fair value recognised in the income statement, the embedded derivative is bifurcated and carried at fair value as a derivative in accordance with IAS 39. In Jackson, the embedded derivative liabilities for GMWB liabilities are fair valued using the economic assumptions shown below, in line with IAS 39 (FAS 157 – Fair Value Measurements.)

Where a significant insurance element is present, such as for Guaranteed Minimum Death Benefit (GMDB) and 'for life' GMWB, the guarantees are accounted for as part of the accounting applied to the host insurance contracts. Under IFRS4, the insurance contract accounting applied prior to IFRS adoption has continued to be applied. Accordingly for US variable annuity business the US GAAP standards applicable to insurance contract accounting are applied. Consistent with that approach, the GMDB and 'for life' GMWB guarantees are valued under FASB ASC Topic 944 (sub-topics 944-20, 944-40 and 944-80) Financial Services – Insurance – Separate Accounts, formerly known as "SOP03-1" (Statement of Position 03-1: "Accounting and Reporting by Insurance Enterprises Contracts and for Separate Accounts").

The two reserving methodologies typically produce quite different patterns of results. It is the variation in assumptions, and the way the two reserving methods react to emerging experience, that produces potentially significant differences in reserve patterns through time.

Both methods determine a hypothetical fee or charge (referred to in the rest of this note as "fee assessment") that is anticipated to fund future projected benefit payments arising using the assumptions applicable for that method. After determination at issue, the FAS 157 fee assessment is fixed for the life of the policy, so that variations in experience from that assumed at issue, as well as cash flow timing issues, will create a liability or asset as the value of future benefits becomes more or less, respectively, than the value of the fee assessments.

The SOP 03-1 fee assessment, on the other hand, is recomputed at each valuation date to take into account emerging experience and cash flow timing differences. After redetermination based on valuation date parameters, the new fee assessment is applied retrospectively from issue date to recompute the current reserve provision. This retrospective aspect of the calculation is not present in the FAS 157 methodology.

The chart below compares the assumption bases for the two methods in general terms as well as showing representative comparative values as of December 31, 2010. The comparative values for the projected earned rate and AA corporate bond rate are the 10-year rate in both cases, and the comparative value for volatility is the 5-year rate.

| Assumption | SOP 03-1 | IAS 39 (FAS 157) |
|---|---|---|
| Fund earned rate | 8.4 % before fees | Quoted rate swap curve<br>(10-year rate:- 3.4% before fees) |
| Discount rate | 8.4% | AA corporate rate curve<br>(10-year rate:- 4.8%) |
| Equity volatility | 15% | Implied curve<br>(5 year volatility:- 24% ) |

To provide an approximate translation of values from the SOP 03-1 basis to the IAS 39 basis, the table below shows estimates of the impact of changing each primary economic assumption from the SOP 03-1 values to the IAS 39 values.

Two other items are shown in addition: a reconciling item to account for the difference in how each method adjusts for emerging economic experience (labelled as the "method" component below), and a further adjustment to recognise the impact of additional fees collected over and above those considered for reserving purposes (i.e. the difference between fees actually collected and the hypothetical fee assessment referenced earlier).

Guaranteed Benefit Liability Supplemental Disclosure as of 31 December 2010

| | Note | GMDB | GMWB "for life" | GMWB "not for life" | Total |
|---|---|---|---|---|---|
| As recorded in the 31 December 2010 financial statements: | | £m | £m | £m | £m |
| --SOP 03-1 | 1 | 220 | 29 | | 249 |
| --IAS 39 fair value | 1 | | | 201 | 201 |
| Total per 31 December 2010 financial statements | | | | | 450 |
| Change in assumed fund earned rate | 2 | 375 | 25 | n/a | 400 |
| Change in discount rate | 3 | 200 | 50 | n/a | 250 |
| Change in equity volatility assumption | 4 | 225 | 0 | n/a | 225 |
| Change in method | 5 | (150) | (25) | n/a | (175) |
| | | | | | 700 |
| Hypothetical IAS 39 basis fair value | 6 | 870 | 280 | | 1,150 |
| Adjustment to full fees | 7 | (200) | (600) | | (800) |
| Hypothetical fair value with full fee recognition | 8 | 670 | (320) | | 350 |

**Notes**

1 Note GMWB benefits have reported components on both an SOP 03-1 and IAS 39 basis.

2 Change in fund earned rate: 8.4 per cent to 3.4 per cent, producing significantly higher values of future benefit payments due to lower future assumed fund growth and therefore greater potential for future guaranteed benefit payouts. For GMWBs, future fee income is less dramatically affected, given that for most benefit forms fee income is based on a more stable benefit base rather than a current account value.

3 Change in discount rate: 8.4 per cent to 4.8 per cent, producing significantly higher values, both for future benefit payments and future fees, with a net increase in liability. The absolute impact of this item will be influenced not only by the rate difference, but also by current market conditions, as the proportional impact of a particular rate change will be diluted if applied to a lower absolute value of future cash flows.

4 Change in equity volatility assumption: 15 per cent to 24 per cent, producing higher values, primarily for future benefit payments. The impact is muted for GMWBs due primarily to the length of time until benefit payments occur, and also by the SOP 03-1 methodology itself.

5 Generally, it is expected that the SOP 03-1 methodology will "lag" market events in terms of reflecting their impact in the reserve calculation. This is because of the retrospective aspect of the calculation described above. This line item is also the balancing item in the reconciliation so contains any cross-effects from other variables.

6 Representation of an approximate hypothetical IAS 39 (FAS 157)value were all guaranteed benefits to be reported on this basis.

7 Value of actual fees collected, on an IAS 39 assumption basis, over and above those already considered in the reserve calculation. The reserve calculation restricts the level of future guarantee fees to a level that is sufficient to meet the expected benefit payments at issue using at issue assumptions to avoid profit recognition at inception.

8 Resulting modified hypothetical IAS 39 (FAS 157) value including adjustment for the value of fees in excess of those considered in the reserve calculation.

In all cases, values shown above, were they to be reflected in actual financial statements, would be significantly offset by an adjustment to deferred acquisition costs, which is impacted by changes in gross profit elements of the variable annuity product. Thus, for example, it might be expected that the GMDB impacts shown would be offset by some 70 to 75 per cent of the change illustrated, and the GMWB impacts shown would be offset by some 50-55% of the change illustrated. The table below illustrates the approximate impact on shareholders' equity.

Estimated impact on Shareholders' Equity

| | Accounts carrying value to hypothetical IAS 39 basis fair value | Accounts carrying value to hypothetical fair value with full fee recognition |
|---|---|---|
| Estimated increase/(decrease) in liability | 700 | (100) |
| Related adjustments to: | | |
| DAC | (475) | (50) |
| Deferred tax | (75) | 50 |
| Estimated Decrease/(increase) in Shareholders' Equity | 150 | (100) |

All numbers rounded to the nearest £25 million.

## 6 Funds under management

**(i)** Summary

| | **2010** £bn | 2009 £bn |
|---|---|---|
| Business area | | |
| Asian operations | **30.9** | 23.7 |
| US operations | **63.6** | 49.6 |
| UK operations | **145.2** | 135.6 |
| Internal funds under management | **239.7** | 208.9 |
| External funds (note (i)) | **100.4** | 80.9 |
| Total funds under management | **340.1** | 289.8 |

**Note**

(i) External funds shown above for 2010 of £100.4 billion (2009: £80.9 billion) comprise £111.4 billion (2009: £89.8 billion) in respect of investment products, as published in the New Business schedules (see schedule VIII) less £11.0 billion (2009: £8.9 billion) that are classified within internal funds.

**(ii)** Internal funds under management – analysis by business area

| | **Asian operations** | | **US operations** | | **UK operations** | | **Total** | |
|---|---|---|---|---|---|---|---|---|
| | **2010** £bn | 2009 £bn | **2010** £bn | 2009 £bn | **2010** £bn | 2009 £bn | **2010** £bn | 2009 £bn |
| Investment properties (note (i)) | **-** | - | **0.1** | 0.1 | **11.5** | 11.0 | **11.6** | 11.1 |
| Equity securities | **14.5** | 11.4 | **31.5** | 21.0 | **40.7** | 37.0 | **86.7** | 69.4 |
| Debt securities | **14.1** | 10.0 | **26.4** | 22.8 | **75.9** | 69.1 | **116.4** | 101.9 |
| Loans and receivables | **1.3** | 1.2 | **4.2** | 4.3 | **3.8** | 3.3 | **9.3** | 8.8 |
| Other investments | **1.0** | 1.1 | **1.4** | 1.4 | **13.3** | 15.2 | **15.7** | 17.7 |
| Total | **30.9** | 23.7 | **63.6** | 49.6 | **145.2** | 135.6 | **239.7** | 208.9 |

**Note**

(i) As included in the investments section of the consolidated statement of financial position at 31 December 2010 except for £0.4 billion (2009: £0.2 billion) investment properties which are held-for-sale or occupied by the Group and, accordingly under IFRS, are included in other statement of financial position captions.

## 7 Foreign currency translation

**(i)** Rates of exchange

The profit and loss accounts of foreign subsidiaries are translated at average exchange rates for the year. Assets and liabilities of foreign subsidiaries are translated at closing exchange rates. Foreign currency borrowings that have been used to provide a hedge against Group equity investments in overseas subsidiaries are also translated at closing exchange rates. The impact of these translations is recorded as a component of the movement in shareholders' equity.

The following translation rates have been applied:

| Local currency: £ | **Closing 2010** | **Average 2010** | Closing 2009 | Average 2009 |
|---|---|---|---|---|
| Hong Kong | **12.17** | **12.01** | 12.52 | 12.14 |
| Indonesia | **14,106.51** | **14,033.41** | 15,171.52 | 16,173.28 |
| Malaysia | **4.83** | **4.97** | 5.53 | 5.51 |
| Singapore | **2.01** | **2.11** | 2.27 | 2.27 |
| India | **70.01** | **70.66** | 75.15 | 75.70 |
| Vietnam | **30,526.26** | **29,587.63** | 29,832.74 | 27,892.39 |
| USA | **1.57** | **1.55** | 1.61 | 1.57 |

(ii) Effect of rate movements on results

| IFRS basis results | **As published 2010 (note (i))** £m | Memorandum 2009 (note (i) and (ii)) £m |
|---|---|---|
| Asian operations: | | |
| Long-term operations | **536** | 451 |
| Development expenses | **(4)** | (6) |
| Total Asian insurance operations after development costs | **532** | 445 |
| Asset management | **72** | 58 |
| Total Asia operations | **604** | 503 |
| US operations | | |
| Jackson(note (iii)) | **833** | 626 |
| Broker-dealer, asset management and Curian operations | **22** | 4 |
| Total US operations | **855** | 630 |
| UK operations | | |
| Long-term business | **673** | 606 |
| General insurance commission | **46** | 51 |
| Total UK insurance operations | **719** | 657 |
| M&G | **284** | 238 |
| Total UK operations | **1,003** | 895 |
| Total segment profit | **2,462** | 2,028 |
| Other income and expenditure | **(450)** | (396) |
| Solvency II implementation costs | **(45)** | (23) |
| Restructuring costs | **(26)** | - |
| Operating profit from continuing operations based on longer-term investment returns | **1,941** | 1,609 |
| Shareholders' funds | **8,031** | 6,473 |

| EEV basis results | As published 2010 (note (i)) £m | Memorandum 2009 (note (i) and (ii)) £m |
|---|---|---|
| Asian operations: | | |
| New business: | | |
| Excluding Japan | **902** | 783 |
| Japan | **(1)** | (13) |
| Total | **901** | 770 |
| Business in force | **549** | 420 |
| Long-term operations | **1,450** | 1,190 |
| Asset management | **72** | 58 |
| Development expenses | **(4)** | (6) |
| Total Asia operations | **1,518** | 1,242 |
| US operations | | |
| New business | **761** | 673 |
| Business in force | **697** | 576 |
| Jackson | **1,458** | 1,249 |
| Broker-dealer, asset management and Curian operations | **22** | 4 |
| Total US operations | **1,480** | 1,253 |
| UK operations | | |
| New business | **365** | 230 |
| Business in force | **571** | 640 |
| Long-term business | **936** | 870 |
| General insurance commission | **46** | 51 |
| Total insurance | **982** | 921 |
| M&G | **284** | 238 |
| Total UK operations | **1,266** | 1,159 |
| | | |
| Other income and expenditure | **(494)** | (434) |
| Solvency II implementation costs | **(46)** | - |
| Restructuring costs | **(28)** | (27) |
| Operating profit from continuing operations based on longer-term investment returns | **3,696** | 3,193 |
| Shareholders' funds | **18,207** | 15,904 |

**Notes**

(i) The 'as published' operating profit for 2010 and 'memorandum' operating profit for 2009 have been calculated by applying average 2010 exchange rates (CER).
The 'as published' shareholders' funds for 2010 and memorandum' shareholders' funds for 2009 have been calculated by applying closing period end 2010 exchange rates.

(ii) The 2009 operating profit of Asian long-term operations excludes the results of the Taiwan agency business for which the sale process was completed in June 2009.

(iii) The Company has amended the presentation of IFRS operating profit for its US insurance operations to remove the net equity hedge accounting credit/charge (incorporating related amortisation of deferred acquisition costs) and include it in short-term fluctuations. The 2009 'memorandum' operating profit amounts have been amended accordingly.

## 8 New Business Schedules

**BASIS OF PREPARATION**

The new business schedules are provided as an indicative volume measure of transactions undertaken in the reporting period that have the potential to generate profits for shareholders. The amounts shown are not, and not intended to be, reflective of premium income recorded in the IFRS income statement.

The format of the schedules is consistent with the distinction between insurance and investment products as applied for previous financial reporting periods. Products categorised as "insurance" refer to those classified as contracts of long-term insurance business for regulatory reporting purposes, i.e. falling within one of the classes of insurance specified in part II of Schedule 1 to the Regulated Activities Order under FSA regulations.

The details shown for insurance products include contributions for contracts that are classified under IFRS 4 "Insurance Contracts" as not containing significant insurance risk. These products are described as investment contracts or other financial instruments under IFRS. Contracts included in this category are primarily certain unit-linked and similar contracts written in UK Insurance Operations, and Guaranteed Investment Contracts and similar funding agreements written in US Operations.

New business premiums for regular premium products are shown on an annualised basis. Department of Work and Pensions rebate business is classified as single recurrent business. Internal vesting business is classified as new business where the contracts include an open market option.

Investment products referred to in the tables for funds under management are unit trusts, mutual funds and similar types of retail fund management arrangements. These are unrelated to insurance products that are classified as investment contracts under IFRS 4, as described in the preceding paragraph, although similar IFRS recognition and measurement principles apply to the acquisition costs and fees attaching to this type of business.

**Notes to Schedules 8(a) – 8(f)**

(1a) Insurance and investment new business for overseas operations has been calculated using average exchange rates. The applicable rate for Jackson is 1.55.
(1b) Insurance and investment new business for overseas operations for 2009 has been calculated using constant exchange rates. The applicable rate for Jackson is 1.55.
(2) New business values are all presented pre-tax.
(3) Annual Equivalents, calculated as regular new business contributions plus ten per cent of single new business contributions, are subject to roundings. PVNBPs are calculated as equalling single premiums plus the present value of expected premiums of new regular premium business. In determining the present value, allowance is made for lapses and other assumptions applied in determining the EEV new business profit.
(4) Balance includes segregated and pooled pension funds, private finance assets and other institutional clients. Other movements reflect the net flows arising from the cash component of a tactical asset allocation fund managed by PPM South Africa.
(5) New business in India is included at Prudential's 26 per cent interest in the India life operation.
(6) Balance Sheet figures have been calculated at the closing exchange rate.
(7) Sales are converted using the year to date average exchange rate applicable at the time. The sterling results for individual quarters represent the difference between the year to date reported sterling results at successive quarters and will include foreign exchange movements from earlier periods.
(8) New business in China is included at Prudential's 50 per cent interest in the China life operation.
(9) Mandatory Provident Fund (MPF) product sales in Hong Kong are included at Prudential's 36 per cent interest in Hong Kong MPF operation.

## Schedule 8(a) – Reported Exchange Rates
## Prudential plc – NEW BUSINESS –2010
## INSURANCE OPERATIONS

| | Single | | | Regular | | | Annual Equivalents[3] | | | PVNBP | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2010 YTD £m | 2009 YTD £m | +/- (%) | 2010 YTD £m | 2009 YTD £m | +/- (%) | 2010 YTD £m | 2009 YTD £m | +/- (%) | 2010 YTD £m | 2009 YTD £m | +/- (%) |
| **Group Insurance Operations** | | | | | | | | | | | | |
| Asia – ex Japan[1a] | **1,104** | 785 | 41% | **1,391** | 1,131 | 23% | **1,501** | 1,209 | 24% | **7,493** | 5,982 | 25% |
| US[1a] | **11,417** | 8,885 | 29% | **22** | 24 | (8%) | **1,164** | 912 | 28% | **11,572** | 9,048 | 28% |
| UK | **5,656** | 4,768 | 19% | **254** | 246 | 3% | **820** | 723 | 13% | **6,842** | 5,902 | 16% |
| **Group Total – ex Japan** | **18,177** | 14,438 | 26% | **1,667** | 1,401 | 19% | **3,485** | 2,844 | 23% | **25,907** | 20,932 | 24% |
| Japan | **13** | 57 | (77%) | **6** | 46 | (87%) | **7** | 52 | (87%) | **39** | 263 | (85%) |
| **Group Total** | **18,190** | 14,495 | 26% | **1,673** | 1,447 | 16% | **3,492** | 2,896 | 21% | **25,946** | 21,195 | 22% |
| | | | | | | | | | | | | |
| **Asian Insurance Operations[1a]** | | | | | | | | | | | | |
| Hong Kong | **107** | 94 | 14% | **276** | 232 | 19% | **287** | 241 | 19% | **1,693** | 1,414 | 20% |
| Indonesia | **141** | 41 | 244% | **269** | 186 | 45% | **283** | 190 | 49% | **1,011** | 671 | 51% |
| Malaysia | **58** | 63 | (8%) | **198** | 140 | 41% | **204** | 146 | 40% | **1,153** | 814 | 42% |
| Philippines | **64** | 14 | 357% | **17** | 10 | 70% | **23** | 11 | 109% | **108** | 39 | 177% |
| Singapore | **318** | 297 | 7% | **143** | 98 | 46% | **175** | 128 | 37% | **1,357** | 1,033 | 31% |
| Thailand | **15** | 14 | 7% | **25** | 14 | 79% | **26** | 16 | 63% | **100** | 54 | 85% |
| Vietnam | **1** | 1 | 0% | **41** | 35 | 17% | **41** | 35 | 17% | **148** | 128 | 16% |
| **SE Asia Operations inc. Hong Kong** | **704** | 524 | 34% | **969** | 715 | 36% | **1,039** | 767 | 35% | **5,570** | 4,153 | 34% |
| China[8] | **103** | 72 | 43% | **48** | 38 | 26% | **58** | 45 | 29% | **336** | 253 | 33% |
| India[5] | **85** | 47 | 81% | **180** | 163 | 10% | **188** | 168 | 12% | **582** | 581 | 0% |
| Korea | **66** | 38 | 74% | **89** | 118 | (25%) | **96** | 122 | (21%) | **486** | 568 | (14%) |
| Taiwan | **146** | 104 | 40% | **105** | 97 | 8% | **120** | 107 | 12% | **519** | 427 | 22% |
| **Total Asia Operations - ex Japan** | **1,104** | 785 | 41% | **1,391** | 1,131 | 23% | **1,501** | 1,209 | 24% | **7,493** | 5,982 | 25% |
| | | | | | | | | | | | | |
| **US Insurance Operations[1a]** | | | | | | | | | | | | |
| Fixed Annuities | **836** | 1,053 | (21%) | **-** | - | 0% | **84** | 105 | (20%) | **836** | 1,053 | (21%) |
| Fixed Index Annuities | **1,089** | 1,433 | (24%) | **-** | - | 0% | **109** | 143 | (24%) | **1,089** | 1,433 | (24%) |
| Life | **11** | 10 | 10% | **22** | 24 | (8%) | **23** | 25 | (8%) | **166** | 173 | (4%) |
| Variable Annuities | **9,481** | 6,389 | 48% | **-** | - | 0% | **948** | 639 | 48% | **9,481** | 6,389 | 48% |
| **Total US Insurance Operations** | **11,417** | 8,885 | 29% | **22** | 24 | (8%) | **1,164** | 912 | 28% | **11,572** | 9,048 | 28% |
| | | | | | | | | | | | | |
| **UK & Europe Insurance Operations** | | | | | | | | | | | | |
| Direct and Partnership Annuities | **593** | 590 | 1% | **-** | - | 0% | **59** | 59 | 0% | **593** | 590 | 1% |
| Intermediated Annuities | **221** | 242 | (9%) | **-** | - | 0% | **22** | 24 | (8%) | **221** | 242 | (9%) |
| Internal Vesting Annuities | **1,235** | 1,357 | (9%) | **-** | - | 0% | **124** | 136 | (9%) | **1,235** | 1,357 | (9%) |
| **Total Individual Annuities** | **2,049** | 2,189 | (6%) | **-** | - | 0% | **205** | 219 | (6%) | **2,049** | 2,189 | (6%) |
| Corporate Pensions | **228** | 192 | 19% | **198** | 191 | 4% | **221** | 210 | 5% | **1,099** | 1,007 | 9% |
| On-shore Bonds | **1,660** | 1,444 | 15% | **-** | - | 0% | **166** | 145 | 15% | **1,660** | 1,444 | 15% |
| Other Products | **774** | 881 | (12%) | **56** | 55 | 2% | **133** | 143 | (7%) | **1,089** | 1,200 | (9%) |
| Wholesale | **945** | 62 | 1,424% | **-** | - | 0% | **95** | 6 | 1,483% | **945** | 62 | 1,424% |
| **Total UK & Europe Insurance Ops** | **5,656** | 4,768 | 19% | **254** | 246 | 3% | **820** | 723 | 13% | **6,842** | 5,902 | 16% |
| **Group Total – ex Japan** | **18,177** | 14,438 | 26% | **1,667** | 1,401 | 19% | **3,485** | 2,844 | 23% | **25,907** | 20,932 | 24% |

The Prudential's European operation is based in Ireland and sells products into Jersey, Guernsey, Isle of Man, Gibraltar, Cyprus, Malta, Belgium, Spain and UK.

## Schedule 8(b) – Current Exchange Rates
## Prudential plc – NEW BUSINESS –2010
## INSURANCE OPERATIONS

| | Single | | | Regular | | | Annual Equivalents[3] | | | PVNBP | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2010 YTD £m | 2009 YTD £m | +/- (%) | 2010 YTD £m | 2009 YTD £m | +/- (%) | 2010 YTD £m | 2009 YTD £m | +/- (%) | 2010 YTD £m | 2009 YTD £m | +/- (%) |
| **Group Insurance Operations** | | | | | | | | | | | | |
| Asia – ex Japan[1b] | **1,104** | 840 | 31% | **1,391** | 1,216 | 14% | **1,501** | 1,300 | 15% | **7,493** | 6,407 | 17% |
| US[1b] | **11,417** | 9,000 | 27% | **22** | 24 | (8%) | **1,164** | 924 | 26% | **11,572** | 9,165 | 26% |
| UK | **5,656** | 4,768 | 19% | **254** | 246 | 3% | **820** | 723 | 13% | **6,842** | 5,902 | 16% |
| **Group Total – ex Japan** | **18,177** | 14,608 | 24% | **1,667** | 1,486 | 12% | **3,485** | 2,947 | 18% | **25,907** | 21,474 | 21% |
| Japan | **13** | 61 | (79%) | **6** | 50 | (88%) | **7** | 56 | (88%) | **39** | 284 | (86%) |
| **Group Total** | **18,190** | 14,669 | 24% | **1,673** | 1,536 | 9% | **3,492** | 3,003 | 16% | **25,946** | 21,758 | 19% |
| **Asian Insurance Operations[1b]** | | | | | | | | | | | | |
| Hong Kong | **107** | 95 | 13% | **276** | 234 | 18% | **287** | 244 | 18% | **1,693** | 1,429 | 18% |
| Indonesia | **141** | 47 | 200% | **269** | 214 | 26% | **283** | 219 | 29% | **1,011** | 773 | 31% |
| Malaysia | **58** | 70 | (17%) | **198** | 156 | 27% | **204** | 163 | 25% | **1,153** | 901 | 28% |
| Philippines | **64** | 14 | 357% | **17** | 11 | 55% | **23** | 12 | 92% | **108** | 42 | 157% |
| Singapore | **318** | 320 | (1%) | **143** | 106 | 35% | **175** | 138 | 27% | **1,357** | 1,115 | 22% |
| Thailand | **15** | 16 | (6%) | **25** | 15 | 67% | **26** | 17 | 53% | **100** | 59 | 69% |
| Vietnam | **1** | 1 | 0% | **41** | 33 | 24% | **41** | 33 | 24% | **148** | 121 | 22% |
| **SE Asia Operations inc. Hong Kong** | **704** | 563 | 25% | **969** | 769 | 26% | **1,039** | 826 | 26% | **5,570** | 4,440 | 25% |
| China[8] | **103** | 74 | 39% | **48** | 39 | 23% | **58** | 46 | 26% | **336** | 259 | 30% |
| India[5] | **85** | 51 | 67% | **180** | 174 | 3% | **188** | 179 | 5% | **582** | 622 | (6%) |
| Korea | **66** | 42 | 57% | **89** | 131 | (32%) | **96** | 135 | (29%) | **486** | 633 | (23%) |
| Taiwan | **146** | 110 | 33% | **105** | 103 | 2% | **120** | 114 | 5% | **519** | 453 | 15% |
| **Total Asia Operations - ex Japan** | **1,104** | 840 | 31% | **1,391** | 1,216 | 14% | **1,501** | 1,300 | 15% | **7,493** | 6,407 | 17% |
| **US Insurance Operations[1b]** | | | | | | | | | | | | |
| Fixed Annuities | **836** | 1,067 | (22%) | **-** | - | 0% | **84** | 107 | (21%) | **836** | 1,067 | (22%) |
| Fixed Index Annuities | **1,089** | 1,452 | (25%) | **-** | - | 0% | **109** | 145 | (25%) | **1,089** | 1,452 | (25%) |
| Life | **11** | 10 | 10% | **22** | 24 | (8%) | **23** | 25 | (8%) | **166** | 175 | (5%) |
| Variable Annuities | **9,481** | 6,471 | 47% | **-** | - | 0% | **948** | 647 | 47% | **9,481** | 6,471 | 47% |
| **Total US Insurance Operations** | **11,417** | 9,000 | 27% | **22** | 24 | (8%) | **1,164** | 924 | 26% | **11,572** | 9,165 | 26% |
| **UK & Europe Insurance Operations** | | | | | | | | | | | | |
| Direct and Partnership Annuities | **593** | 590 | 1% | **-** | - | 0% | **59** | 59 | 0% | **593** | 590 | 1% |
| Intermediated Annuities | **221** | 242 | (9%) | **-** | - | 0% | **22** | 24 | (8%) | **221** | 242 | (9%) |
| Internal Vesting Annuities | **1,235** | 1,357 | (9%) | **-** | - | 0% | **124** | 136 | (9%) | **1,235** | 1,357 | (9%) |
| **Total Individual Annuities** | **2,049** | 2,189 | (6%) | **-** | - | 0% | **205** | 219 | (6%) | **2,049** | 2,189 | (6%) |
| Corporate Pensions | **228** | 192 | 19% | **198** | 191 | 4% | **221** | 210 | 5% | **1,099** | 1,007 | 9% |
| On-shore Bonds | **1,660** | 1,444 | 15% | **-** | - | 0% | **166** | 145 | 15% | **1,660** | 1,444 | 15% |
| Other Products | **774** | 881 | (12%) | **56** | 55 | 2% | **133** | 143 | (7%) | **1,089** | 1,200 | (9%) |
| Wholesale | **945** | 62 | 1,424% | **-** | - | 0% | **95** | 6 | 1,483% | **945** | 62 | 1,424% |
| **Total UK & Europe Insurance Ops** | **5,656** | 4,768 | 19% | **254** | 246 | 3% | **820** | 723 | 13% | **6,842** | 5,902 | 16% |
| **Group Total – ex Japan** | **18,177** | 14,608 | 24% | **1,667** | 1,486 | 12% | **3,485** | 2,947 | 18% | **25,907** | 21,474 | 21% |

**Schedule 8(c) - Reported Exchange Rates**
**PRUDENTIAL PLC - NEW BUSINESS - 2010**
**TOTAL INSURANCE NEW BUSINESS APE - BY QUARTER**

| | 2009 | | | | 2010 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 £m | Q2 £m | Q3 £m | Q4 £m | Q1 £m | Q2 £m | Q3 £m | Q4 £m |
| **Group Insurance Operations** | | | | | | | | |
| Asia – ex Japan(1a)(7) | 276 | 248 | 282 | 403 | 359 | 354 | 353 | **435** |
| US(1a)(7) | 184 | 208 | 249 | 272 | 255 | 305 | 290 | **314** |
| UK | 180 | 197 | 158 | 189 | 193 | 189 | 166 | **272** |
| **Group Total - ex Japan** | **640** | **652** | **689** | **864** | **807** | **848** | **809** | **1,021** |
| Japan(1a)(7) | 17 | 12 | 11 | 12 | 7 | - | - | **-** |
| **Group Total** | **656** | **664** | **700** | **876** | **814** | **848** | **809** | **1,021** |
| | | | | | | | | |
| **Asian Insurance Operations(1a)(7)** | | | | | | | | |
| Hong Kong | 46 | 49 | 55 | 91 | 68 | 62 | 65 | **92** |
| Indonesia | 38 | 46 | 43 | 64 | 61 | 68 | 59 | **95** |
| Malaysia | 24 | 29 | 32 | 62 | 36 | 41 | 52 | **75** |
| Philippines | 2 | 2 | 3 | 4 | 5 | 5 | 6 | **7** |
| Singapore | 22 | 30 | 29 | 48 | 33 | 42 | 43 | **57** |
| Thailand | 4 | 3 | 4 | 4 | 5 | 8 | 7 | **6** |
| Vietnam | 5 | 9 | 9 | 11 | 8 | 10 | 10 | **13** |
| **SE Asia Operations inc. Hong Kong** | **141** | **168** | **175** | **284** | **216** | **236** | **242** | **345** |
| China(8) | 11 | 11 | 13 | 11 | 14 | 13 | 15 | **16** |
| India(5) | 56 | 20 | 40 | 52 | 73 | 46 | 48 | **21** |
| Korea | 37 | 29 | 30 | 26 | 22 | 24 | 23 | **27** |
| Taiwan | 31 | 20 | 26 | 30 | 34 | 35 | 25 | **26** |
| **Total Asian Insurance Operations - ex Japan** | **276** | **248** | **282** | **403** | **359** | **354** | **353** | **435** |
| | | | | | | | | |
| **US Insurance Operations(1a)(7)** | | | | | | | | |
| Fixed Annuities | 48 | 22 | 14 | 21 | 18 | 24 | 24 | **18** |
| Fixed Index Annuities | 25 | 33 | 48 | 38 | 30 | 30 | 24 | **25** |
| Life | 6 | 6 | 6 | 6 | 6 | 5 | 6 | **6** |
| Variable Annuities | 105 | 147 | 180 | 207 | 201 | 246 | 236 | **265** |
| **Total US Insurance Operations** | **184** | **208** | **249** | **272** | **255** | **305** | **290** | **314** |
| | | | | | | | | |
| **UK & Europe Insurance Operations** | | | | | | | | |
| Direct and Partnership Annuities | 13 | 14 | 15 | 17 | 20 | 16 | 14 | **9** |
| Intermediated Annuities | 6 | 8 | 6 | 5 | 6 | 6 | 5 | **5** |
| Internal Vesting annuities | 39 | 34 | 30 | 33 | 33 | 31 | 29 | **31** |
| **Total Individual Annuities** | **58** | **56** | **50** | **55** | **59** | **53** | 48 | **45** |
| Corporate Pensions | 52 | 62 | 41 | 55 | 60 | 62 | 48 | **51** |
| On-shore Bonds | 34 | 42 | 34 | 35 | 33 | 36 | 41 | **56** |
| Other Products | 35 | 35 | 33 | 41 | 40 | 38 | 27 | **28** |
| Wholesale | 1 | 1 | 1 | 3 | 1 | - | 2 | **92** |
| **Total UK & Europe Insurance Operations** | **180** | **197** | **158** | **189** | **193** | **189** | **166** | **272** |
| **Group Total – ex Japan** | **640** | **652** | **689** | **864** | **807** | **848** | **809** | **1,021** |

**Schedule 8(d) - Current Exchange Rates**
**PRUDENTIAL PLC - NEW BUSINESS – 2010**
**TOTAL INSURANCE NEW BUSINESS APE - BY QUARTER**

| | 2009 | | | | 2010 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 £m | Q2 £m | Q3 £m | Q4 £m | Q1 £m | Q2 £m | Q3 £m | Q4 £m |
| **Group Insurance Operations** | | | | | | | | |
| Asia – ex Japan[1b][7] | 285 | 267 | 314 | **434** | 359 | 354 | 353 | **435** |
| US[1b][7] | 171 | 207 | 261 | **285** | 255 | 305 | 290 | **314** |
| UK | 180 | 197 | 158 | **189** | 193 | 189 | 166 | **272** |
| **Group Total - ex Japan** | **636** | **671** | **733** | **908** | **807** | **848** | **809** | **1,021** |
| Japan[1b][7] | 17 | 14 | 13 | **13** | 7 | - | - | **-** |
| **Group Total** | **653** | **685** | **746** | **921** | **814** | **848** | **809** | **1,021** |
| | | | | | | | | |
| **Asian Insurance Operations**[1b][7] | | | | | | | | |
| Hong Kong | 43 | 49 | 58 | **94** | 68 | 62 | 65 | **92** |
| Indonesia | 45 | 53 | 50 | **71** | 61 | 68 | 59 | **95** |
| Malaysia | 25 | 32 | 36 | **70** | 36 | 41 | 52 | **75** |
| Philippines | 2 | 2 | 3 | **5** | 5 | 5 | 6 | **7** |
| Singapore | 22 | 32 | 32 | **52** | 33 | 42 | 43 | **57** |
| Thailand | 4 | 4 | 5 | **4** | 5 | 8 | 7 | **6** |
| Vietnam | 5 | 8 | 9 | **11** | 8 | 10 | 10 | **13** |
| **SE Asia Operations inc. Hong Kong** | **146** | **180** | **193** | **307** | **216** | **236** | **242** | **345** |
| China[8] | 10 | 11 | 13 | **12** | 14 | 13 | 15 | **16** |
| India[5] | 56 | 23 | 45 | **55** | 73 | 46 | 48 | **21** |
| Korea | 42 | 32 | 34 | **27** | 22 | 24 | 23 | **27** |
| Taiwan | 31 | 21 | 29 | **33** | 34 | 35 | 25 | **26** |
| **Total Asian Insurance Operations - ex Japan** | **285** | **267** | **314** | **434** | **359** | **354** | **353** | **435** |
| | | | | | | | | |
| **US Insurance Operations**[1b][7] | | | | | | | | |
| Fixed Annuities | 45 | 23 | 16 | **23** | 18 | 24 | 24 | **18** |
| Fixed Index Annuities | 23 | 33 | 50 | **39** | 30 | 30 | 24 | **25** |
| Life | 6 | 6 | 6 | **7** | 6 | 5 | 6 | **6** |
| Variable Annuities | 97 | 145 | 189 | **216** | 201 | 246 | 236 | **265** |
| **Total US Insurance Operations** | **171** | **207** | **261** | **285** | **255** | **305** | **290** | **314** |
| | | | | | | | | |
| **UK & Europe Insurance Operations** | | | | | | | | |
| Direct and Partnership Annuities | 13 | 14 | 15 | **17** | 20 | 16 | 14 | **9** |
| Intermediated Annuities | 6 | 8 | 6 | **5** | 6 | 6 | 5 | **5** |
| Internal Vesting annuities | 39 | 34 | 30 | **33** | 33 | 31 | 29 | **31** |
| **Total Individual Annuities** | **58** | **56** | **50** | **55** | **59** | **53** | **48** | **45** |
| Corporate Pensions | 52 | 62 | 41 | **55** | 60 | 62 | 48 | **51** |
| On-shore Bonds | 34 | 42 | 34 | **35** | 33 | 36 | 41 | **56** |
| Other Products | 35 | 35 | 33 | **41** | 40 | 38 | 27 | **28** |
| Wholesale | 1 | 1 | 1 | **3** | 1 | - | 2 | **92** |
| **Total UK & Europe Insurance Operations** | **180** | **197** | **158** | **189** | **193** | **189** | **166** | **272** |
| **Group Total – ex Japan** | **636** | **671** | **733** | **908** | **807** | **848** | **809** | **1,021** |

**Schedule 8 (e) - Reported Exchange Rates**
**PRUDENTIAL PLC - NEW BUSINESS – 2010**
**INVESTMENT OPERATIONS - BY QUARTER**

| | 2009 | | | | 2010 | | | |
|---|---|---|---|---|---|---|---|---|
| | **Q1** | **Q2** | **Q3** | **Q4** | **Q1** | **Q2** | **Q3** | **Q4** |
| | **£m** | **£m** | **£m** | **£m** | **£m** | **£m** | **£m** | **£m** |
| **Group Investment Operations** | | | | | | | | |
| Opening FUM | 62,279 | 61,703 | 72,336 | 85,016 | 89,780 | 96,746 | 96,015 | **104,451** |
| Net Flows | 2,725 | 7,344 | 2,898 | 2,450 | 1,203 | 3,173 | 1,802 | **2,712** |
| - Gross Inflows | 19,154 | 25,567 | 26,394 | 24,942 | 24,173 | 27,182 | 25,727 | **29,887** |
| - Redemptions | (16,429) | (18,223) | (23,496) | (22,492) | (22,970) | (24,009) | (23,925) | **(27,175)** |
| Other Movements | (3,301) | 3,289 | 9,782 | 2,314 | 5,763 | (3,904) | 6,634 | **4,211** |
| **Total Group Investment Operations** | **61,703** | **72,336** | **85,016** | **89,780** | **96,746** | **96,015** | **104,451** | **111,374** |
| **M&G** | | | | | | | | |
| **Retail** | | | | | | | | |
| Opening FUM | 19,142 | 19,671 | 23,324 | 28,504 | 31,059 | 34,069 | 33,724 | **38,232** |
| Net Flows | 2,207 | 1,863 | 1,656 | 1,790 | 1,454 | 1,922 | 1,742 | **2,298** |
| - Gross Inflows | 3,325 | 3,126 | 3,315 | 3,802 | 4,190 | 4,450 | 3,986 | **5,285** |
| - Redemptions | (1,118) | (1,263) | (1,659) | (2,012) | (2,736) | (2,528) | (2,244) | **(2,987)** |
| Other Movements | (1,678) | 1,790 | 3,524 | 765 | 1,556 | (2,267) | 2,766 | **1,976** |
| Closing FUM | 19,671 | 23,324 | 28,504 | 31,059 | 34,069 | 33,724 | 38,232 | **42,506** |
| **Institutional[(4)]** | | | | | | | | |
| Opening FUM | 27,855 | 26,865 | 32,597 | 37,731 | 39,247 | 42,155 | 41,946 | **44,694** |
| Net Flows | 336 | 4,219 | 856 | 551 | 435 | 863 | (206) | **597** |
| - Gross Inflows | 1,083 | 5,097 | 2,495 | 2,632 | 2,151 | 2,581 | 1,630 | **2,099** |
| - Redemptions | (747) | (878) | (1,639) | (2,081) | (1,716) | (1,718) | (1,836) | **(1,502)** |
| Other Movements | (1,326) | 1,513 | 4,278 | 965 | 2,473 | (1,072) | 2,954 | **1,529** |
| Closing FUM | 26,865 | 32,597 | 37,731 | 39,247 | 42,155 | 41,946 | 44,694 | **46,820** |
| **Total M&G Investment Operations** | **46,536** | **55,921** | **66,235** | **70,306** | **76,224** | **75,670** | **82,926** | **89,326** |
| **Asia** | | | | | | | | |
| **Equity/Bond/Other[(9)]** | | | | | | | | |
| Opening FUM | 10,570 | 10,038 | 10,636 | 12,492 | 13,122 | 14,923 | 14,497 | **15,825** |
| Net Flows | (370) | 174 | 322 | 57 | 166 | 1,031 | 446 | **103** |
| - Gross Inflows | 911 | 1,083 | 1,725 | 1,512 | 1,713 | 3,414 | 3,248 | **3,423** |
| - Redemptions | (1,281) | (909) | (1,403) | (1,455) | (1,547) | (2,383) | (2,802) | **(3,320)** |
| Other Movements | (162) | 424 | 1,534 | 573 | 1,635 | (1,457) | 882 | **430** |
| Closing FUM | 10,038 | 10,636 | 12,492 | 13,122 | 14,923 | 14,497 | 15,825 | **16,358** |
| **Third Party Institutional Mandates** | | | | | | | | |
| Opening FUM | 789 | 799 | 859 | 1,008 | 1,450 | 1,549 | 1,604 | **1,680** |
| Net Flows | 1 | 2 | (2) | 372 | 5 | 125 | (39) | **-** |
| - Gross Inflows | 24 | 10 | 5 | 378 | 12 | 137 | 14 | **12** |
| - Redemptions | (23) | (8) | (7) | (6) | (7) | (12) | (53) | **(12)** |
| Other Movements | 9 | 58 | 151 | 70 | 94 | (70) | 115 | **127** |
| Closing FUM | 799 | 859 | 1,008 | 1,450 | 1,549 | 1,604 | 1,680 | **1,807** |
| **MMF** | | | | | | | | |
| Opening FUM | 3,873 | 4,286 | 4,882 | 5,281 | 4,902 | 4,050 | 4,244 | **4,020** |
| Net Flows | 554 | 1,095 | 115 | (321) | (857) | (768) | (141) | **(286)** |
| - Gross Inflows | 13,808 | 16,248 | 18,854 | 16,618 | 16,107 | 16,600 | 16,849 | **19,068** |
| - Redemptions | (13,254) | (15,153) | (18,739) | (16,939) | (16,964) | (17,368) | (16,990) | **(19,354)** |
| Other Movements | (141) | (499) | 284 | (58) | 5 | 962 | (83) | **149** |
| Closing FUM | 4,286 | 4,882 | 5,281 | 4,902 | 4,050 | 4,244 | 4,020 | **3,883** |
| **Total Asian Investment Operations** | **15,123** | **16,377** | **18,781** | **19,474** | **20,522** | **20,345** | **21,525** | **22,048** |
| **US** | | | | | | | | |
| **Retail** | | | | | | | | |
| Opening FUM | 50 | 44 | 38 | - | - | - | - | - |
| Net Flows | (3) | (9) | (49) | 1 | - | - | - | - |
| - Gross Inflows | 3 | 3 | - | - | - | - | - | - |
| - Redemptions | (6) | (12) | (49) | 1 | - | - | - | - |
| Other Movements | (3) | 3 | 11 | (1) | - | - | - | - |
| Closing FUM | 44 | 38 | - | - | - | - | - | - |
| Curian Capital - FUM | **1,613** | **1,646** | **2,041** | **2,260** | **2,708** | **2,781** | **3,038** | **3,457** |

**Schedule 8 (f) - Reported Exchange Rates**
**PRUDENTIAL PLC - NEW BUSINESS – 2010**
**TOTAL INSURANCE NEW BUSINESS PROFIT AND MARGIN (% APE AND % PVNBP)**

| | 2009 | | | | 2010 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 YTD £m | Q2 YTD £m | Q3 YTD £m | Q4 YTD £m | Q1 YTD £m | Q2 YTD £m | Q3 YTD £m | Q4 YTD £m |
| **Annual Equivalent**(3) | | | | | | | | |
| Total Asian Insurance Operations - ex Japan | 276 | 524 | 806 | 1,209 | 359 | 713 | 1,066 | **1,501** |
| Total US Insurance Operations | 184 | 392 | 640 | 912 | 255 | 560 | 850 | **1,164** |
| Total UK & Europe Insurance Operations | 180 | 376 | 534 | 723 | 193 | 382 | 548 | **820** |
| **Group Total - ex Japan** | **640** | **1,292** | **1,980** | **2,844** | **807** | **1,655** | **2,464** | **3,485** |
| Japan | 17 | 29 | 40 | 52 | 7 | 7 | 7 | **7** |
| **Group Total** | **657** | **1,321** | **2,020** | **2,896** | **814** | **1,662** | **2,471** | **3,492** |
| **New business profit**(2) | | | | | | | | |
| Total Asian Insurance Operations - ex Japan | 136 | 286 | 465 | 725 | 183 | 396 | 621 | **902** |
| Total US Insurance Operations | 140 | 292 | 482 | 664 | 175 | 361 | 532 | **761** |
| Total UK & Europe Insurance Operations | 60 | 122 | 169 | 230 | 69 | 135 | 192 | **365** |
| **Group Total - ex Japan** | **336** | **700** | **1,116** | **1,619** | **427** | **892** | **1,345** | **2,028** |
| Japan | (4) | (9) | (12) | (12) | (1) | (1) | (1) | **(1)** |
| **Group Total** | **332** | **691** | **1,104** | **1,607** | **426** | **891** | **1,344** | **2,027** |
| **New business margin (% of APE)** | | | | | | | | |
| Total Asian Insurance Operations - ex Japan | 49% | 55% | 58% | 60% | 51% | 56% | 58% | **60%** |
| Total US Insurance Operations | 76% | 74% | 75% | 73% | 69% | 64% | 63% | **65%** |
| Total UK & Europe Insurance Operations | 33% | 32% | 32% | 32% | 36% | 35% | 35% | **45%** |
| **Group Total - ex Japan** | **53%** | **54%** | **56%** | **57%** | **53%** | **54%** | **55%** | **58%** |
| Japan | (24%) | (31%) | (30%) | (23%) | (14%) | (14%) | (14%) | **(14%)** |
| **Group Total** | **51%** | **52%** | **55%** | **56%** | **52%** | **54%** | **54%** | **58%** |
| **PVNBP**(3) | | | | | | | | |
| Total Asian Insurance Operations - ex Japan | 1,297 | 2,551 | 3,987 | 5,982 | 1,581 | 3,316 | 5,071 | **7,493** |
| Total US Insurance Operations | 1,840 | 3,889 | 6,360 | 9,048 | 2,538 | 5,569 | 8,457 | **11,572** |
| Total UK & Europe Insurance Operations | 1,490 | 3,062 | 4,372 | 5,902 | 1,557 | 3,081 | 4,463 | **6,842** |
| **Group Total - ex Japan** | **4,627** | **9,502** | **14,719** | **20,932** | **5,676** | **11,966** | **17,991** | **25,907** |
| Japan | 82 | 155 | 212 | 263 | 32 | 34 | 36 | **39** |
| **Group Total** | **4,709** | **9,657** | **14,931** | **21,195** | **5,708** | **12,000** | **18,027** | **25,946** |
| **New business profit**(2) | | | | | | | | |
| Total Asian Insurance Operations - ex Japan | 136 | 286 | 465 | 725 | 183 | 396 | 621 | **902** |
| Total US Insurance Operations | 140 | 292 | 482 | 664 | 175 | 361 | 532 | **761** |
| Total UK & Europe Insurance Operations | 60 | 122 | 169 | 230 | 69 | 135 | 192 | **365** |
| **Group Total - ex Japan** | **336** | **700** | **1,116** | **1,619** | **427** | **892** | **1,345** | **2,028** |
| Japan | (4) | (9) | (12) | (12) | (1) | (1) | (1) | **(1)** |
| **Group Total** | **332** | **691** | **1,104** | **1,607** | **426** | **891** | **1,344** | **2,027** |
| **New business margin (% of PVNBP)** | | | | | | | | |
| Total Asian Insurance Operations - ex Japan | 10.5% | 11.2% | 11.7% | 12.1% | 11.6% | 11.9% | 12.2% | **12.0%** |
| Total US Insurance Operations | 7.6% | 7.5% | 7.6% | 7.3% | 6.9% | 6.5% | 6.3% | **6.6%** |
| Total UK & Europe Insurance Operations | 4.0% | 4.0% | 3.9% | 3.9% | 4.4% | 4.4% | 4.3% | **5.3%** |
| **Group Total - ex Japan** | **7.3%** | **7.4%** | **7.6%** | **7.7%** | **7.5%** | **7.5%** | **7.5%** | **7.8%** |
| Japan | (4.9%) | (5.8%) | (5.7%) | (4.6%) | (3.1%) | (2.9%) | (2.8%) | **(2.6%)** |
| **Group Total** | **7.1%** | **7.2%** | **7.4%** | **7.6%** | **7.5%** | **7.4%** | **7.5%** | **7.8%** |

# European Embedded Value (EEV) basis results



## Notes on EEV basis results

# European Embedded Value (EEV) basis results

## Operating profit based on longer-term investment returns[i]

### *Results analysis by business area*

| | Note | **2010 £m** | 2009 £m[v] |
|---|---|---|---|
| **Asian operations** | | | |
| New business: | | | |
| Excluding Japan | 2 | **902** | 725 |
| Japan[iv] | | **(1)** | (12) |
| Total | | **901** | 713 |
| Business in force | 3 | **549** | 392 |
| Long-term business | | **1,450** | 1,105 |
| Asset management | | **72** | 55 |
| Development expenses | | **(4)** | (6) |
| Total | | **1,518** | 1,154 |
| **US operations** | | | |
| New business | 2 | **761** | 664 |
| Business in force | 3 | **697** | 569 |
| Long-term business | | **1,458** | 1,233 |
| Broker-dealer and asset management | | **22** | 4 |
| Total | | **1,480** | 1,237 |
| **UK operations** | | | |
| New business | 2 | **365** | 230 |
| Business in force | 3 | **571** | 640 |
| Long-term business | | **936** | 870 |
| General insurance commission | | **46** | 51 |
| Total UK insurance operations | | **982** | 921 |
| M&G | | **284** | 238 |
| Total | | **1,266** | 1,159 |
| **Other income and expenditure** | | | |
| Investment return and other income | | **30** | 22 |
| Interest payable on core structural borrowings | | **(257)** | (209) |
| Corporate expenditure | | **(220)** | (203) |
| Charge for share-based payments for Prudential schemes | | **(3)** | (5) |
| Charge for expected asset management margin[ii] | | **(44)** | (38) |
| Total | | **(494)** | (433) |
| Solvency II implementation costs [iii] | | **(46)** | - |
| Restructuring costs[iii] | | **(28)** | (27) |
| **Operating profit based on longer-term investment returns[i]** | | **3,696** | 3,090 |
| Analysed as profits (losses) from: | | | |
| New business: | | | |
| Excluding Japan | 2 | **2,028** | 1,619 |
| Japan[iv] | | **(1)** | (12) |
| Total | | **2,027** | 1,607 |
| Business in force | 3 | **1,817** | 1,601 |
| Long-term business | | **3,844** | 3,208 |
| Asset management | | **378** | 297 |
| Other results | | **(526)** | (415) |
| Total | | **3,696** | 3,090 |

**Notes**

i EEV basis operating profit based on longer-term investment returns excludes the recurrent items of short-term fluctuations in investment returns, the mark to market value movements on core borrowings, the shareholders' share of actuarial and other gains and losses on defined benefit pension schemes, and the effect of changes in economic assumptions. In addition, for 2010, operating profit excludes costs associated with the terminated AIA transaction and the gain arising upon the dilution of the Group's holding in PruHealth. For 2009, operating profit excluded the non-recurrent cost of hedging the Group IGD capital surplus included within short-term fluctuations in investment returns and the profit on sale and results of the sold Taiwan agency business.

The amounts for these items are included in total EEV profit attributable to shareholders. The Company believes that operating profit, as adjusted for these items, better reflects underlying performance. Profit before tax and basic earnings per share include these items together with actual investment returns. This basis of presentation has been adopted consistently throughout these results.

ii The value of future profits or losses from asset management and service companies that support the Group's covered businesses are included in the profits for new business and the in-force value of the Group's long-term business. The results of the Group's asset management operations include the profits from management of internal and external funds. For EEV basis reporting, Group shareholders' other income is adjusted to deduct the expected margins for the period on management of covered business. The deduction is on a basis consistent with that used for projecting the results for covered business. Group operating profit accordingly includes the variance between actual and expected profit in respect of covered business.

iii Restructuring costs comprise the charge of £(26) million recognised on an IFRS basis and an additional £(2) million recognised on the EEV basis for the shareholders' share of restructuring costs incurred by the PAC with-profits fund (2009: £(23) million on an IFRS basis and an additional £(4) million on the EEV basis). For 2010, Solvency II implementation costs comprise the charge of £(45) million recognised on an IFRS basis and an additional £(1) million recognised on the EEV basis.

iv New business profits for the Group's Japanese insurance subsidiary, which ceased selling new business with effect from 15 February 2010, have been presented separately from those of the remainder of the Group.

v Exchange translation
The comparative results have been prepared using previously reported average exchange rates for the year.

## Summarised consolidated income statement

| | Note | 2010 £m | 2009 £m |
|---|---|---|---|
| **Operating profit based on longer-term investment returns** | | | |
| Asian operations | | **1,518** | 1,154 |
| US operations | | **1,480** | 1,237 |
| UK operations: | | | |
| UK insurance operations | | **982** | 921 |
| M&G | | **284** | 238 |
| | | **1,266** | 1,159 |
| Other income and expenditure | | **(494)** | (433) |
| Solvency II implementation costs | | **(46)** | - |
| Restructuring costs | | **(28)** | (27) |
| **Operating profit based on longer-term investment returns** | | **3,696** | 3,090 |
| Short-term fluctuations in investment returns | 4 | **(30)** | 351 |
| Mark to market value movements on core borrowings | 9 | **(164)** | (795) |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | | **(11)** | (84) |
| Effect of changes in economic assumptions | 5 | **(10)** | (910) |
| Costs of terminated AIA transaction | 6 | **(377)** | - |
| Gain on dilution of holding in PruHealth | 18 | **3** | - |
| Profit on sale and results for Taiwan agency business | 19 | **-** | 91 |
| **Profit from continuing operations before tax (including actual investment returns)** | | **3,107** | 1,743 |
| Tax attributable to shareholders' profit | 11 | **(530)** | (481) |
| **Profit from continuing operations after tax before non-controlling interests** | | **2,577** | 1,262 |
| Discontinued operations (net of tax) | | - | (14) |
| **Profit for the year** | | **2,577** | 1,248 |
| Attributable to: | | | |
| Equity holders of the Company | | **2,573** | 1,245 |
| Non-controlling interests | | **4** | 3 |
| **Profit for the year** | | **2,577** | 1,248 |

## Earnings per share (in pence)

| | Note | 2010 | 2009 |
|---|---|---|---|
| From operating profit based on longer-term investment returns, after related tax and non-controlling interests of £2,700m* (2009: £2,221m) | 12 | **106.9p** | 88.8p |
| Based on profit after tax and non-controlling interests of £2,573m (2009: £1,245m) | 12 | **101.9p** | 49.8p |

* excluding an exceptional tax credit of £158 million which primarily relates to the impact of a settlement agreed with the UK tax authorities - see note 11.

## Dividends per share (in pence)

| | 2010 | 2009 |
|---|---|---|
| Dividends relating to reporting year: | | |
| Interim dividend (2010 and 2009) | **6.61p** | 6.29p |
| Final/second interim dividend (2010 and 2009) | **17.24p** | 13.56p |
| Total | **23.85p** | 19.85p |
| Dividends declared and paid in reporting year: | | |
| Current year interim dividend | **6.61p** | 6.29p |
| Second interim/final dividend for prior year | **13.56p** | 12.91p |
| Total | **20.17p** | 19.20p |

## Movement in shareholders' equity (excluding non-controlling interests)

| | Note | 2010 £m | 2009 £m |
|---|---|---|---|
| Profit for the year attributable to equity shareholders | | **2,573** | 1,245 |
| Items taken directly to equity: | | | |
| Exchange movements on foreign operations and net investment hedges: | | | |
| Exchange movements arising during the year | | **659** | (761) |
| Related tax | | **34** | 11 |
| Dividends | | **(511)** | (481) |
| New share capital subscribed (including shares issued in lieu of cash dividends) | | **75** | 141 |
| Reserve movements in respect of share-based payments | | **37** | 29 |
| Treasury shares: | | | |
| Movement in own shares held in respect of share-based payment plans | | **(4)** | 3 |
| Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS | | **3** | (3) |
| Mark to market value movements on Jackson assets backing surplus and required capital (gross movement) | | **105** | 205 |
| Related tax | | **(37)** | (72) |
| Net increase in shareholders' equity | 10 | **2,934** | 317 |
| Shareholders' equity at beginning of year (excluding non-controlling interests) | 7,10 | **15,273** | 14,956 |
| **Shareholders' equity at end of year (excluding non-controlling interests)** | 7,10 | **18,207** | 15,273 |

| | | 2010 £m | | | 2009 £m | | |
|---|---|---|---|---|---|---|---|
| **Comprising:** | Note | **Long-term business operations** | **Asset management and other operations** | **Total** | Long-term business operations | Asset management and other operations | Total |
| Asian operations: | | | | | | | |
| Net assets of operations | | **7,445** | **197** | **7,642** | 5,781 | 161 | 5,942 |
| Acquired goodwill | | **236** | **61** | **297** | 80 | 61 | 141 |
| | 7 | **7,681** | **258** | **7,939** | 5,861 | 222 | 6,083 |
| US operations: | | | | | | | |
| Net assets of operations | | **4,799** | **106** | **4,905** | 4,122 | 95 | 4,217 |
| Acquired goodwill | | **-** | **16** | **16** | - | 16 | 16 |
| | 7 | **4,799** | **122** | **4,921** | 4,122 | 111 | 4,233 |
| UK insurance operations: | | | | | | | |
| Net assets of operations | | **5,970** | **33** | **6,003** | 5,439 | 37 | 5,476 |
| M&G: | | | | | | | |
| Net assets of operations | | **-** | **254** | **254** | - | 173 | 173 |
| Acquired goodwill | | **-** | **1,153** | **1,153** | - | 1,153 | 1,153 |
| | | **-** | **1,407** | **1,407** | - | 1,326 | 1,326 |
| | 7 | **5,970** | **1,440** | **7,410** | 5,439 | 1,363 | 6,802 |
| Other operations: | | | | | | | |
| Holding company net borrowings at market value | 9 | **-** | **(2,212)** | **(2,212)** | - | (1,780) | (1,780) |
| Other net assets (liabilities) | | **-** | **149** | **149** | - | (65) | (65) |
| | 7 | **-** | **(2,063)** | **(2,063)** | - | (1,845) | (1,845) |
| **Shareholders' equity at end of year (excluding non-controlling interests)** | 7 | **18,450** | **(243)** | **18,207** | 15,422 | (149) | 15,273 |
| Representing: | | | | | | | |
| Net assets | | **18,214** | **(1,473)** | **16,741** | 15,342 | (1,379) | 13,963 |
| Acquired goodwill | | **236** | **1,230** | **1,466** | 80 | 1,230 | 1,310 |
| | | **18,450** | **(243)** | **18,207** | 15,422 | (149) | 15,273 |

| **Net asset value per share (in pence)** | **2010** | 2009 |
|---|---|---|
| Based on EEV basis shareholders' equity of £18,207 million (2009: £15,273 million) | **715p** | 603p |
| Number of issued shares at year end (millions) | **2,546** | 2,532 |
| **Return on embedded value*** | **18%** | 15% |

* Return on embedded value is based on EEV operating profit after tax and non-controlling interests (adjusted to exclude an exceptional tax credit of £158 million (as shown in note 11) as a percentage of opening EEV basis shareholders' equity.

## Summary statement of financial position

| | Note | 2010 £m | 2009 £m |
|---|---|---|---|
| **Total assets less liabilities, before deduction for insurance funds** | | **231,667** | 201,501 |
| Less insurance funds:* | | | |
| Policyholder liabilities (net of reinsurers' share) and unallocated surplus of with-profits funds | | **(223,636)** | (195,230) |
| Less shareholders' accrued interest in the long-term business | | **10,176** | 9,002 |
| | | **(213,460)** | (186,228) |
| **Total net assets** | 7,10 | **18,207** | 15,273 |
| | | | |
| Share capital | | **127** | 127 |
| Share premium | | **1,856** | 1,843 |
| IFRS basis shareholders' reserves | | **6,048** | 4,301 |
| Total IFRS basis shareholders' equity | 7 | **8,031** | 6,271 |
| Additional EEV basis retained profit | 7 | **10,176** | 9,002 |
| **Shareholders' equity (excluding non-controlling interests)** | 7,10 | **18,207** | 15,273 |

*Including liabilities in respect of insurance products classified as investment contracts under IFRS 4.

# Notes on the EEV basis result

## 1 Basis of preparation, methodology and accounting presentation

The EEV basis results have been prepared in accordance with the EEV Principles issued by the CFO Forum of European Insurance Companies in May 2004 and expanded by the Additional Guidance on EEV Disclosures published in October 2005. Where appropriate, the EEV basis results include the effects of adoption of International Financial Reporting Standards (IFRS).

The directors are responsible for the preparation of the supplementary information in accordance with the EEV Principles.

The EEV basis results for 2010 and 2009 have been derived from the EEV basis results supplement to the Company's statutory accounts for 2010. The supplement included an unqualified audit report from the auditors.

### *a Covered business*

The EEV results for the Group are prepared for 'covered business', as defined by the EEV Principles. Covered business represents the Group's long-term insurance business for which the value of new and in-force contracts is attributable to shareholders. The EEV basis results for the Group's covered business are then combined with the IFRS basis results of the Group's other operations.

The definition of long-term business operations is consistent with previous practice and comprises those contracts falling under the definition of long-term insurance business for regulatory purposes together with, for US operations, contracts that are in substance the same as guaranteed investment contracts (GICs) but do not fall within the technical definition. Under the EEV Principles, the results for covered business incorporate the projected margins of attaching internal asset management.

With two principal exceptions, covered business comprises the Group's long-term business operations. The principal exceptions are for the closed Scottish Amicable Insurance Fund (SAIF) and for the presentational treatment of the financial position of the Group's principal defined benefit pension scheme, the Prudential Staff Pension Scheme (PSPS). A small amount of UK group pensions business is also not modelled for EEV reporting purposes.

SAIF is a ring-fenced sub-fund of the Prudential Assurance Company (PAC) long-term fund, established by a Court approved Scheme of Arrangement in October 1997. SAIF is closed to new business and the assets and liabilities of the fund are wholly attributable to the policyholders of the fund.

As regards PSPS, the deficit funding liability attaching to the shareholder-backed business is included in the total for Other operations, reflecting the fact that the deficit funding is being paid for by the parent company, Prudential plc.

### *b Methodology*

#### *i Embedded value*

**Overview**

The embedded value is the present value of the shareholders' interest in the earnings distributable from assets allocated to covered business after sufficient allowance has been made for the aggregate risks in that business. The shareholders' interest in the Group's long-term business comprises:

- present value of future shareholder cash flows from in-force covered business (value of in-force business), less deductions for:
  - the cost of locked-in required capital;
  - the time value of cost of options and guarantees
- locked-in required capital; and
- shareholders' net worth in excess of required capital (free surplus).

The value of future new business is excluded from the embedded value.

Notwithstanding the basis of presentation of results (as explained in note 1c(iv)) no smoothing of market or account balance values, unrealised gains or investment return is applied in determining the embedded value or profit before tax. Separately, the analysis of profit is delineated between operating profit based on longer-term investment returns and other constituent items, as explained in note 1c(i).

### *Valuation of in-force and new business*

The embedded value results are prepared incorporating best estimate assumptions about all relevant factors including levels of future investment returns, expenses, persistency and mortality. These assumptions are used to project future cash flows. The present value of the future cash flows is then calculated using a discount rate which reflects both the time value of money and the non-diversifiable risks associated with the cash flows that are not otherwise allowed for.

***Best estimate assumptions***

Best estimate assumptions are used for the cash flow projections, where best estimate is defined as the mean of the distribution of future possible outcomes. The assumptions are reviewed actively and changes are made when evidence exists that material changes in future experience are reasonably certain.

Assumptions required in the calculation of the value of options and guarantees, for example relating to volatilities and correlations, or dynamic algorithms linking liabilities to assets, have been set equal to the best estimates and, wherever material and practical, reflect any dynamic relationships between the assumptions and the stochastic variables.

***Principal economic assumptions***

For the Group's UK and US operations, the 2010 and 2009 EEV basis results have been determined using economic assumptions where the long-term expected rates of return on investments and risk discount rates are set by reference to period end rates of return on cash or fixed income securities (the 'active' basis).

For Asian operations, the 2009 EEV basis results for Japan, Korea and US dollar denominated business written in Hong Kong were determined on the 'active' basis. For other Asian countries the investment return assumptions and risk discount rates for 2009 were based on an assessment of longer-term economic conditions (the 'passive' basis).
In 2010, the approach has been altered to determine the EEV basis results for all Asian territories on an active basis of economic assumption setting, in line with the Group's other operations, and reflecting the fact that markets in a number of Asian countries are becoming increasingly developed.

For those Asian operations whose EEV basis results were previously determined on the 'passive' basis of economic assumption setting, the effect of the change in 2010 to move to an 'active' basis is as follows:

| | £m |
|---|---|
| Pre-tax operating profits from: | |
| New business (note 2) | 5 |
| Business in-force (note 3) | (58) |
| Total | (53) |
| Effect on short-term fluctuations in investment returns and changes in economic assumptions | 16 |
| Total profit before tax | (37) |
| **Shareholders' funds as at 31 December 2010** | **(39)** |

For 2010 and 2009, for all the Group's operations, expected returns on equity and property asset classes are derived by adding a risk premium, based on the long-term view of Prudential's economists to the risk free rate.

The total profit that emerges over the lifetime of an individual contract as calculated using the embedded value basis is the same as that calculated under the IFRS basis. Since the embedded value basis reflects discounted future cash flows, under this methodology the profit emergence is advanced thus more closely aligning the timing of the recognition of profits with the efforts and risks of current management actions, particularly with regard to business sold during the year.

**New Business**
The contribution from new business represents profits determined by applying operating assumptions as at the end of the year.
In determining the new business contribution for UK immediate annuity and lifetime mortgage business, which is interest rate sensitive, it is appropriate to use assumptions reflecting point of sale market conditions, consistent with how the business is priced. For other business within the Group, end of period economic assumptions are used.

**Valuation movements on investments**
With the exception of debt securities held by Jackson, investment gains and losses during the year (to the extent that changes in capital values do not directly match changes in liabilities) are included directly in the profit for the year and shareholders' equity as they arise.
The results for any covered business conceptually reflects the aggregate of the IFRS results and the movements on the additional shareholders' interest recognised on the EEV basis. Thus the start point for the calculation of the EEV results for Jackson, as for other businesses, reflects the market value movements recognised on the IFRS basis.
However, in determining the movements on the additional shareholders' interest, the basis for calculating the Jackson EEV result acknowledges that for debt securities backing liabilities the aggregate EEV results reflect the fact that the value of in-force business instead incorporates the discounted value of future spread earnings. This value is not affected generally by short-term market movements on securities that are broadly speaking held for the longer-term.
Fixed income securities backing the free surplus and required capital for Jackson are accounted for at fair value. However, consistent with the treatment applied under IFRS for Jackson securities classified as available-for-sale, movements in unrealised appreciation on these securities are accounted for in equity rather than in the income statement, as shown in the movement in shareholders' equity.

**Cost of capital**
A charge is deducted from the embedded value for the cost of capital supporting the Group's long-term business. This capital is referred to as required capital. The cost is the difference between the nominal value of the capital and the discounted value of the projected releases of this capital allowing for investment earnings (net of tax) on the capital.
The annual result is affected by the movement in this cost from year-to-year which comprises a charge against new business profit and generally a release in respect of the reduction in capital requirements for business in force as this runs off.
Where required capital is held within a with-profits long-term fund, the value placed on surplus assets in the fund is already discounted to reflect its release over time and no further adjustment is necessary in respect of required capital.

**Financial options and guarantees**
***Nature of options and guarantees in Prudential's long-term business***
*Asian operations*
Subject to local market circumstances and regulatory requirements, the guarantee features described below in respect of UK business broadly apply to similar types of participating contracts principally written in the PAC Hong Kong branch, Singapore and Malaysia. Participating products have both guaranteed and non-guaranteed elements.
Non-participating long-term products are the only ones where the insurer is contractually obliged to provide guarantees on all benefits. Whole of life contracts with floor levels of policyholder benefits that accrue at rates set at inception and do not vary subsequent with market conditions are written in the Korean life operations and also are a feature of the UOB in-force

book acquired in 2010. The amounts of these policies written in these operations are much smaller than the amounts of similar policies written by the Taiwan Life business which was sold in the first half of 2009, as detailed in note 19.

*US operations (Jackson)*
The principal options and guarantees in Jackson are associated with the fixed annuity and Variable Annuity (VA) lines of business.

Fixed annuities provide that, at Jackson's discretion, it may reset the interest rate credited to policyholders' accounts, subject to a guaranteed minimum. The guaranteed minimum return varies from 1.5 per cent to 5.5 per cent (2009: 1.5 per cent to 5.5 per cent), depending on the particular product, jurisdiction where issued, and date of issue. At 31 December 2010, 83 per cent (2009: 82 per cent) of the account values on fixed annuities relates to policies with guarantees of 3 per cent or less. The average guarantee rate is 2.9 per cent (2009: 3.0 per cent).

Fixed annuities also present a risk that policyholders will exercise their option to surrender their contracts in periods of rapidly rising interest rates, possibly requiring Jackson to liquidate assets at an inopportune time.

Jackson issues VA contracts where it contractually guarantees to the contract holder either: a) return of no less than total deposits made to the contract adjusted for any partial withdrawals, b) total deposits made to the contract adjusted for any partial withdrawals plus a minimum return, or c) the highest contract value on a specified anniversary date adjusted for any withdrawals following the specified contract anniversary. These guarantees include benefits that are payable at specified dates during the accumulation period (Guaranteed Minimum Withdrawal Benefit (GMWB)), as death benefits (Guaranteed Minimum Death Benefits (GMDB)) or as income benefits (Guaranteed Minimum Income Benefits (GMIB)). Jackson reinsures and hedges these risks using equity options and futures contracts. These guarantees generally protect the policyholder's value in the event of poor equity market performance.

Jackson also issues fixed index annuities that enable policyholders to obtain a portion of an equity-linked return while providing a guaranteed minimum return. The guaranteed minimum returns would be of a similar nature to those described above for fixed annuities.

*UK insurance operations*
The only significant financial options and guarantees in the UK insurance operations arise in the with-profits fund and SAIF.

With-profits products provide returns to policyholders through bonuses that are smoothed. There are two types of bonuses: annual and final. Annual bonuses are declared once a year and, once credited, are guaranteed in accordance with the terms of the particular product. Unlike annual bonuses, final bonuses are guaranteed only until the next bonus declaration. The with-profits fund held a provision on the Pillar I Peak 2 basis of £24 million (2009: £31 million) at 31 December 2010 to honour guarantees on a small amount of guaranteed annuity option products.

Beyond the generic features and the provisions held in respect of guaranteed annuities described above, there are very few explicit options or guarantees of the with-profits fund such as minimum investment returns, surrender values, or annuity values at retirement and any granted have generally been at very low levels.

The Group's main exposure to guaranteed annuity options in the UK is through SAIF and a provision on the Pillar I Peak 2 basis of £336 million (2009: £284 million) was held in SAIF at 31 December 2010 to honour the guarantees. As SAIF is a separate sub-fund of the Prudential Assurance Company long-term fund which is attributable to policyholders of the fund, the movement in the provision has no direct impact on shareholders.

*Time value*
The value of financial options and guarantees comprises two parts. One is given by a deterministic valuation on best estimate assumptions (the intrinsic value). The other part arises from the variability of economic outcomes in the future (the time value).

Where appropriate, a full stochastic valuation has been undertaken to determine the value of the in-force business including the cost of capital. A deterministic valuation of the in-force business is also derived using consistent assumptions and the time value of the financial options and guarantees is derived as the difference between the two.

The economic assumptions used for the stochastic calculations are consistent with those used for the deterministic calculations. Assumptions specific to the stochastic calculations reflect local market conditions and are based on a combination of actual market data, historic market data and an assessment of long-term economic conditions. Common principles have been adopted across the Group for the stochastic asset models, for example, separate modelling of individual asset classes but with an allowance for correlation between the various asset classes. Details of the key characteristics of each model are given in note 16.

### *ii Level of required capital*
In adopting the EEV Principles, Prudential has based required capital on its internal targets for economic capital subject to it being at least the local statutory minimum requirements. Economic capital is assessed using internal models but, when applying the EEV Principles, Prudential does not take credit for the significant diversification benefits that exist within the Group. For with-profits business written in a segregated life fund, as is the case in Asia and the UK, the capital available in the fund is sufficient to meet the required capital requirements. For shareholder-backed business the following capital requirements apply:

- Asian operations: the level of required capital has been set at the higher of local statutory requirements and the economic capital requirement;
- US operations: the level of required capital has been set to an amount at least equal to 235 per cent of the risk-based capital required by the National Association of Insurance Commissioners (NAIC) at the Company Action Level (CAL); and
- UK insurance operations: the capital requirements are set at the higher of Pillar I and Pillar II requirements for shareholder-backed business of UK insurance operations as a whole, which for 2010 and 2009 was Pillar I.

### *iii Allowance for risk and risk discount rates*
**Overview**
Under the EEV Principles, discount rates used to determine the present value of future cash flows are set equal to risk-free rates plus a risk margin. The risk margin should reflect any non-diversifiable risk associated with the emergence of distributable earnings that is not allowed for elsewhere in the valuation. Prudential has selected a granular approach to better reflect differences in market risk inherent in each product group. The risk discount rate so derived does not reflect an overall

Group market beta but instead reflects the expected volatility associated with the cash flows for each product category in the embedded value model.

Since financial options and guarantees are explicitly valued under the EEV methodology, discount rates under EEV are set excluding the effect of these product features.

The risk margin represents the aggregate of the allowance for market risk, additional allowance for credit risk where appropriate, and allowance for non-diversifiable non-market risk. No allowance is required for non-market risks where these are assumed to be fully diversifiable. The majority of non-market and non-credit risks are considered to be diversifiable.

**Market risk allowance**

The allowance for market risk represents the beta multiplied by an equity risk premium. Except for UK shareholder-backed annuity business (as explained below) such an approach has been used for all of the Group's businesses.

The beta of a portfolio or product measures its relative market risk. The risk discount rates reflect the market risk inherent in each product group and hence the volatility of product cash flows. These are determined by considering how the profits from each product are affected by changes in expected returns on various asset classes. By converting this into a relative rate of return it is possible to derive a product specific beta.

Product level betas are calculated each year. They are combined with the most recent product mix to produce appropriate betas and risk discount rates for each major product grouping.

**Additional credit risk allowance**

The Group's methodology is to allow appropriately for credit risk. The allowance for credit risk is to cover:

- expected long-term defaults;
- credit risk premium (to reflect the volatility in default levels); and
- short-term downgrades and defaults.

These allowances are initially reflected in determining best-estimate returns and through the market risk allowance described above. However, for those businesses which are largely backed by holdings of debt securities these allowances in the projected returns and market risk allowances may not be sufficient and an additional allowance may be appropriate.

The practical application of the allowance for credit risk varies depending upon the type of business as described below.

*Asian operations*

For Asian operations, the allowance for credit risk incorporated in the projected rates of return and the market risk allowance are sufficient. Accordingly no additional allowance for credit risk is required.

*US business*

For Jackson business, the allowance for long-term defaults is reflected in the risk margin reserve charge which is deducted in determining the projected spread margin between the earned rate on the investments and the policyholder crediting rate.

The risk discount rate incorporates an additional allowance for credit risk premium and short-term defaults for general account business of 150 basis points and for variable annuity business of 30 basis points to reflect the fact that a proportion of the variable annuity business is allocated to the general account.

The level of allowance differs from that for UK annuity business for investment portfolio differences and to take account of the management actions available in adverse economic scenarios to reduce crediting rates to policyholders, subject to guarantee features of the products.

*UK business*

a Shareholder-backed annuity business

For Prudential's UK shareholder-backed annuity business, Prudential has used a market consistent embedded value (MCEV) approach to derive an implied risk discount rate which is then applied to the projected best estimate cash flows.

In the annuity MCEV calculations, the future cash flows are discounted using the swap yield curve plus an allowance for liquidity premium based on Prudential's assessment of the expected return on the assets backing the annuity liabilities after allowing for expected long-term defaults, credit risk premium and short-term downgrades and defaults. For the purposes of presentation in the EEV results, the results on this basis are reconfigured. Under this approach the projected earned rate of return on the debt securities held is determined after allowing for expected long-term defaults and, where necessary, an additional allowance for an element of short-term downgrades and defaults to bring the allowance in the earned rate up to best estimate levels. The allowances for credit risk premium and additional short-term default allowance are incorporated into the risk margin included in the discount rate.

b With-profit fund PAL annuity business

For UK annuity business written by PAL the basis for determining the aggregate allowance for credit risk is consistent with that applied for UK shareholder-backed annuity business and includes provision for short-term defaults and credit risk premium. The allowance for credit risk in PAL is taken into account in determining the projected cash flows to the with-profits fund, which are in turn discounted at the risk discount rate applicable to all of the projected cash flows of the fund.

c With-profit fund holdings of debt securities

The UK with-profits fund holds debt securities as part of its investment portfolio backing policyholder liabilities and unallocated surplus. The assumed earned rate for with-profit holdings of corporate bonds is defined as the risk-free rate plus an assessment of the long-term spread over gilts, net of expected long-term defaults. This approach is similar to that applied for equities and properties for which the projected earned rate is defined as the risk-free rate plus a long-term risk premium.

***Allowance for non-diversifiable non-market risks***

Finance theory cannot be used to determine the appropriate component of beta for non-diversifiable non-market risks since there is no observable risk premium associated with it that is akin to the equity risk premium. Recognising this, a pragmatic approach has been applied.

A base level allowance of 50 basis points is applied to cover the non-diversifiable non-market risks associated with the Group's businesses. For the Group's US business and UK business for other than shareholder-backed annuity, no additional allowance is necessary. For UK shareholder-backed annuity business, an additional allowance of 50 basis points is used to reflect the longevity risk which is of particular relevance. For the Group's Asian operations in China, India, Indonesia, Philippines, Taiwan, Thailand and Vietnam, additional allowances are applied for emerging market risk ranging from 100 to 250 basis points.

### *iv Management actions*
In deriving the time value of financial options and guarantees, management actions in response to emerging investment and fund solvency conditions have been modelled. Management actions encompass, but are not confined to investment allocation decisions, levels of reversionary and terminal bonuses and credited rates. Bonus rates are projected from current levels and varied in accordance with assumed management actions applying in the emerging investment and fund solvency conditions.

In all instances, the modelled actions are in accordance with approved local practice and therefore reflect the options actually available to management. For the PAC with-profits fund, the actions assumed are consistent with those set out in the Principles and Practices of Financial Management.

### *v With-profits business and the treatment of the estate*
The proportion of surplus allocated to shareholders from the PAC with-profits fund has been based on the present level of 10 per cent. The value attributed to the shareholders' interest in the estate is derived by increasing final bonus rates (and related shareholder transfers) so as to exhaust the estate over the lifetime of the in-force with-profits business. In those few extreme scenarios where the total assets of the life fund are insufficient to meet policyholder claims in full, the excess cost is fully attributed to shareholders. Similar principles apply, where appropriate, for other with-profit funds of the Group's Asian operations.

### *vi Pension costs*
The Group operates three defined benefit schemes in the UK. The principal scheme is the Prudential Staff Pension Scheme (PSPS). The other two, much smaller, schemes are the Scottish Amicable and M&G schemes.

Under IFRS the surpluses or deficits attaching to these schemes are accounted for in accordance with the provisions of IAS 19 that apply the principles of IFRIC 14, providing guidance on assessing the limit in IAS 19 on the amount of surplus in a defined benefit pension scheme that can be recognised as an asset.

Under the EEV basis the IAS 19 basis surpluses (to the extent not restricted under IFRIC 14) or deficits are initially allocated in the same manner. The shareholders' 10 per cent interest in the PAC with-profits fund estate is determined after inclusion of the portion of the IAS 19 basis surpluses or deficits attributable to the fund. Adjustments under EEV in respect of accounting for surpluses or deficits on the Scottish Amicable Pension Scheme are reflected as part of UK operations and for other defined benefit schemes the adjustments are reflected as part of 'Other operations', as shown in note 7.

Separately, the projected cash flows of in-force covered business include the cost of contributions to the defined benefit schemes for future service based on the contribution basis applying to the schemes at the time of the preparation of the results.

### *vii Debt capital*
Core structural debt liabilities are carried at market value. As the liabilities are generally held to maturity or for the long-term, no deferred tax asset or liability has been established on the difference, compared to the IFRS carrying value. Accordingly, no deferred tax credit or charge is recorded in the results for the reporting period in respect of the mark to market value adjustment.

### *viii Foreign currency translation*
Foreign currency profits and losses have been translated at average exchange rates for the year. Foreign currency assets and liabilities have been translated at year-end rates of exchange. The purpose of translating the profits and losses at average exchange rates, notwithstanding the fact that EEV profit represents the incremental value added on a discounted cash flow basis, is to maintain consistency with the methodology applied for IFRS basis reporting.

## ***c Accounting presentation***
### *i Analysis of profit before tax*
To the extent applicable, presentation of the EEV profit for the year is consistent with the basis that the Group applies for analysis of IFRS basis profits before shareholder taxes between operating and non-operating results. Operating results reflect the underlying results including longer-term investment returns and, except as explained in note 1c(iv) below, the unwind of discount on the value of in-force business. Operating results include the impact of routine changes of estimates and non-economic assumptions.

Non-operating results comprise the recurrent items of short-term fluctuations in investment returns, the shareholders' share of actuarial and other gains and losses on defined benefit pension schemes, the mark to market value movements on core borrowings and the effect of changes in economic assumptions.

In addition, for 2010, the Company incurred costs associated with the terminated AIA transaction and the Group's holding in PruHealth was diluted. The effect of both of these items has been shown separately from operating profits based on longer-term investment returns.

In 2009, during the severe equity market conditions experienced in the first quarter, coupled with historically high equity volatility, the Group incurred non-recurrent costs from an exceptional short-dated hedge to protect against potential tail events on the Group IGD capital position in addition to regular operational hedging programmes. These costs incurred in 2009 have been shown separately within short-term fluctuations in investment returns. Also, in June 2009, the Group completed the disposal of the Taiwan agency business. The effect of this disposal and the results of the Taiwan agency business have been presented separately outside of the operating result.

### *ii Operating profit*
For the investment element of the assets covering the net worth of long-term insurance business, investment returns are recognised in operating results at the expected long-term rate of return. These expected returns are calculated by reference to the asset mix of the portfolio. For the purpose of calculating the longer-term investment return to be included in the operating result of the PAC with-profits fund of UK operations, where assets backing the liabilities and unallocated surplus are subject to

market volatility, asset values at the beginning of the reporting period are adjusted to remove the effects of short-term market movements as explained in note 1c (iv) below.

For the purpose of determining the long-term returns for debt securities of US operations for fixed annuity and other general account business, a risk margin charge is included which reflects the expected long-term rate of default based on the credit quality of the portfolio. For Jackson, interest-related realised gains and losses are amortised to the operating results over the maturity period of the sold bonds and for equity-related investments, a long-term rate of return is assumed, which reflects the aggregation of year-end risk-free rates and equity risk premium. For US variable annuity separate account business, operating profit includes the unwind of discount on the opening value of in force adjusted to reflect year-end projected rates of return with the excess or deficit of the actual return recognised within non-operating profit, together with the related hedging activity.

For UK annuity business, rebalancing of the asset portfolio backing the liabilities to policyholders may from time to time take place to align it more closely with the internal benchmark of credit quality that management applies. Such rebalancing will result in a change in the projected yield on the asset portfolio and the allowance for default risk. The net effect of these changes is reflected in the result for the year. In general, the effect is booked in operating results.

### *iii Effect of changes in operating assumptions*

Operating profits include the effect of changes to operating assumptions on the value of in-force at the end of the period. For presentational purposes, the effect of change is delineated to show the effect on the opening value of in-force with the experience variance being determined by reference to the end of period assumptions.

### *iv Unwind of discount and other expected returns*

The unwind of discount and other expected returns is determined by reference to the value of in-force business, required capital and surplus assets at the start of the period as adjusted for the effect of changes in economic and operating assumptions reflected in the current period.

For UK insurance operations the amount included within operating results based on longer-term investment returns represents the unwind of discount on the value of in-force business at the beginning of the period (adjusted for the effect of current period assumption changes), the unwind of discount on additional value representing the shareholders' share of smoothed surplus assets retained within the PAC with-profits fund (as explained in note 1b(v) above), and the expected return on shareholders' assets held in other UK long-term business operations. Surplus assets retained within the PAC with-profits fund are smoothed for this purpose to remove the effects of short-term investment volatility from operating results. In the summary statement of financial position and for total profit reporting, asset values and investment returns are not smoothed.

### *v Pension costs*

**Profit before tax**

Movements on the shareholders' share of surpluses (to the extent not restricted by IFRIC 14) and deficits of the Group's defined benefit pension schemes adjusted for contributions paid in the year are recorded within the income statement. Consistent with the basis of distribution of bonuses and the treatment of the estate described in note 1b(iv) and (v), the shareholders' share incorporates 10 per cent of the proportion of the financial position attributable to the PAC with-profits fund. The financial position is determined by applying the requirements of IAS 19.

**Actuarial and other gains and losses**

For pension schemes in which the IAS 19 position reflects the difference between the assets and liabilities of the scheme, actuarial and other gains and losses comprise:

- the difference between actual and expected return on the scheme assets;
- experience gains and losses on scheme liabilities;
- the impact of altered economic and other assumptions on the discounted value of scheme liabilities; and
- for pension schemes where the IAS 19 position reflects a deficit funding obligation, actuarial and other gains and losses includes the movement in estimates of deficit funding requirements.

These items are recorded in the income statement but, consistent with the IFRS basis of presentation, are excluded from operating results based on longer-term investment returns.

### *vi Effect of changes in economic assumptions*

Movements in the value of in-force business at the beginning of the period caused by changes in economic assumptions, net of the related change in the time value of cost of option and guarantees, are recorded in non-operating results.

### *vii Taxation*

The profit for the year for covered business is in most cases calculated initially at the post-tax level. The post-tax profit for covered business is then grossed up for presentation purposes at the effective rates of tax applicable to the countries and periods concerned. In the UK the effective rate applied for 2010 is 27 per cent (2009: 28 per cent). For Jackson, the US federal tax rate of 35 per cent is applied to gross up movements on the value of in-force business. The overall tax rate includes the impact of tax effects determined on a local regulatory basis. For Asia, similar principles apply subject to the availability of taxable profits.

### *viii Inter-company arrangements*

The EEV results for covered business incorporate the effect of the reinsurance arrangement of non-profit immediate pension annuity liabilities of SAIF (which is not covered business) to PRIL. In addition, the analysis of free surplus and value of in-force business takes account of the impact of contingent loan arrangements between Group companies.

## *ix Foreign exchange rates*

Foreign currency results have been translated as discussed in note 1b(viii), for which the principal exchange rates are as follows:

| **Local currency: £** | **Closing rate at 31 Dec 2010** | **Average rate for 2010** | Closing rate at 31 Dec 2009 | Average rate for 2009 | Opening rate at 1 Jan 2009 |
|---|---|---|---|---|---|
| China | **10.32** | **10.46** | 11.02 | 10.70 | 9.86 |
| Hong Kong | **12.17** | **12.01** | 12.52 | 12.14 | 11.14 |
| India | **70.01** | **70.66** | 75.15 | 75.70 | 70.05 |
| Indonesia | **14,106.51** | **14,033.41** | 15,171.52 | 16,173.28 | 15,799.22 |
| Korea | **1,776.86** | **1,786.23** | 1,880.45 | 1,989.75 | 1,810.92 |
| Malaysia | **4.83** | **4.97** | 5.53 | 5.51 | 5.02 |
| Singapore | **2.01** | **2.11** | 2.27 | 2.27 | 2.07 |
| Taiwan | **45.65** | **48.65** | 51.65 | 51.65 | 47.28 |
| US | **1.57** | **1.55** | 1.61 | 1.57 | 1.44 |

## *x Discontinued operations*

The charge of £(14) million in 2009, which is net of £nil tax, reflected completion adjustments for a previously disposed business.

## 2 Analysis of new business contribution[note iv]

| | Year ended 31 Dec 2010 | | | | | | |
|---|---|---|---|---|---|---|---|
| | New business premiums | | Annual premium and contribution equivalents (APE) | Present value of new business premiums (PVNBP) | Pre-tax new business contribution | New business margin note i | |
| | Single | Regular | note i | note i | notes ii,iii | (APE) | (PVNBP) |
| | £m | £m | £m | £m | £m | % | % |
| Asian operations[notes v, vi] | **1,104** | **1,391** | **1,501** | **7,493** | **902** | **60** | **12.0** |
| US operations[note vii] | **11,417** | **22** | **1,164** | **11,572** | **761** | **65** | **6.6** |
| UK insurance operations[note viii] | **5,656** | **254** | **820** | **6,842** | **365** | **45** | **5.3** |
| Total | **18,177** | **1,667** | **3,485** | **25,907** | **2,028** | **58** | **7.8** |

| | Year ended 31 Dec 2009 | | | | | | |
|---|---|---|---|---|---|---|---|
| | New business premiums | | Annual premium and contribution equivalents (APE) | Present value of new business premiums (PVNBP) | Pre-tax new business contribution | New business margin note i | |
| | Single | Regular | note i | note i | notes ii,iii | (APE) | (PVNBP) |
| | £m | £m | £m | £m | £m | % | % |
| Asian operations[note v] | 785 | 1,131 | 1,209 | 5,982 | 725 | 60 | 12.1 |
| US operations[note vii] | 8,885 | 24 | 912 | 9,048 | 664 | 73 | 7.3 |
| UK insurance operations[note viii] | 4,768 | 246 | 723 | 5,902 | 230 | 32 | 3.9 |
| Total | 14,438 | 1,401 | 2,844 | 20,932 | 1,619 | 57 | 7.7 |

| | New business margin (APE) % | |
|---|---|---|
| | **2010** | 2009 |
| Asian operations:[note v] | | |
| China | **47** | 50 |
| Hong Kong | **74** | 70 |
| India | **20** | 19 |
| Indonesia | **75** | 73 |
| Korea | **31** | 44 |
| Taiwan | **13** | 18 |
| Other | **79** | 87 |
| Weighted average for all Asian operations | **60** | 60 |

**Notes**

i New business margins are shown on two bases, namely the margins by reference to Annual Premium Equivalents (APE) and the Present Value of New Business Premiums (PVNBP) and are calculated as the ratio of the value of new business profit to APE and PVNBP. APE are calculated as the aggregate of regular new business amounts and one-tenth of single new business amounts. PVNBP are calculated as equalling single premiums plus the present value of expected premiums of new regular premium business, allowing for lapses and other assumptions made in determining the EEV new business contribution.

ii In determining the EEV basis value of new business written in the period the policies incept, premiums are included in projected cash flows on the same basis of distinguishing annual and single premium business as set out for statutory basis reporting.

iii New business contributions represent profits determined by applying operating assumptions as at the end of the year. In general, the use of point of sale or end of period economic assumptions is not significant in determining the new business contribution for different types of business and across financial reporting periods. However, to obtain proper measurement of the new business contribution for business which is interest rate sensitive, it is appropriate to use assumptions reflecting point of sale market conditions, consistent with how the business was priced. In practice, the only area within the Group where this has a material effect is for UK shareholder-backed annuity business. For other business within the Group end of period economic assumptions are used.

iv The amounts shown in the tables are translated at average exchange rates for the period.

v The tables above include new business for the Taiwan bank distribution operation. New business excludes the Taiwan Agency business, which was sold in June 2009 (as explained in note 19) and the Japanese insurance operations, in which the Company ceased selling new business from 15 February 2010.

vi The new business contribution in 2010 of £902 million for Asian operations includes a benefit of around £5 million arising from the application of the ‘active’ basis of economic assumption setting rather than the previously applied basis of an assessment of longer-term economic conditions, as described in note 1b.

vii The decrease in new business margin for US operations from 2009 to 2010 primarily reflects the changes to the assumed new business spread margins for Fixed Annuity and Fixed Index Annuity business as described in note 16a.

viii The increase in new business margin for UK operations from 2009 to 2010 primarily reflects the signing of a bulk annuity buy-in insurance agreement.

## 3 Operating profit from business in force

### *Group Summary*

| | Year ended 31 Dec 2010 | | | |
|---|---|---|---|---|
| | **Asian operations** note i **£m** | **US operations** note ii **£m** | **UK operations** note iii **£m** | **Total** **£m** |
| Unwind of discount and other expected returns | **573** | **369** | **550** | **1,492** |
| Effect of change in operating assumptions | **(23)** | **3** | **(3)** | **(23)** |
| Experience variances and other items | **(1)** | **325** | **24** | **348** |
| Total | **549** | **697** | **571** | **1,817** |

| | Year ended 31 Dec 2009 | | | |
|---|---|---|---|---|
| | Asian operations note i £m | US operations note ii £m | UK operations note iii £m | Total £m |
| Unwind of discount and other expected returns | 489 | 344 | 588 | 1,421 |
| Effect of change in operating assumptions | (12) | 101 | - | 89 |
| Experience variances and other items | (85) | 124 | 52 | 91 |
| Total | 392 | 569 | 640 | 1,601 |

**Notes**

**Analysis by business unit**

i Asian operations

| | **2010** **£m** | 2009 £m |
|---|---|---|
| Unwind of discount and other expected returns[a] | **573** | 489 |
| Effect of change in operating assumptions: | | |
| Mortality and morbidity[b] | **89** | 26 |
| Expense[c] | **(62)** | (32) |
| Persistency[d] | **(75)** | (78) |
| Other[e] | **25** | 72 |
| | **(23)** | (12) |
| Experience variance and other items: | | |
| Mortality and morbidity[f] | **45** | 52 |
| Expense[g] | **(39)** | (43) |
| Persistency[h] | **(48)** | (76) |
| Other [i] | **41** | (18) |
| | **(1)** | (85) |
| Total Asian operations[j] | **549** | 392 |

**Notes**

a The increase in unwind of discount and other expected returns from £489 million for 2009 to £573 million for 2010 mainly arises from the growth in the opening value of the in-force book.

b The credit of £89 million (2009: £26 million) for mortality and morbidity assumption changes mainly arises in Indonesia of £72 million comprising £36 million for relaxation of morbidity assumptions and £36 million to reflect recent experience in relation to protection benefits provided by unit-linked policies. The favourable effect of £26 million in 2009 primarily arises in Indonesia of £24 million reflecting recent experience.

c The charge of £(62) million in 2010 for expense assumption changes includes a charge in Korea of £(40) million, to reflect higher policy maintenance costs. Also included for 2010 is a charge of £(16) million in Malaysia relating to altered maintenance expense assumptions. The charge of £(32) million for strengthened expense assumptions in 2009 arises principally in Hong Kong of £(23) million with the balance arising across the regions.

d The charge of £(75) million in 2010 for the effect of changes in persistency assumptions mainly arises in Indonesia (£(33) million), Malaysia (£(26) million) and India (£(24) million) partly offset by a credit in Hong Kong (£16 million). The charge in Indonesia of £(33) million primarily relates to Shariah and single premium policies for which lower renewal rates have been experienced. The charge in Malaysia of £(26) million reflects altered premium holiday and other lapse assumptions and the charge in India of £(24) million represents changes in the paid-up assumption on linked business.
The negative effect of the change in persistency assumptions of £(78) million in 2009 are mainly a direct consequence of the impact on policyholders' savings behaviour from adverse economic and market conditions, arising mostly with investment related products, principally in Korea (£(25) million), Indonesia (£(24) million) and Hong Kong (£(12) million).

e The credit of £72 million for other assumption changes in 2009 comprises the one-off positive impact of £69 million for altered projected net of tax cash flows arising from a regulatory reclassification of health and protection products in Hong Kong, a credit of £13 million for the effect of altered application of the Group's EEV methodology and a net charge of £(10) million for other items. The £13 million effect comprises adjustments for asset management margins in Indonesia and Korea of £37 million and a charge of £(24) million to better align the assumed capital requirement with internal management and pricing bases, primarily in China, Indonesia, Philippines and Vietnam, and other minor adjustments with a neutral net effect.

f The favourable effect of £45 million in 2010 (2009: £52 million) for mortality and morbidity experience variances reflects better than expected experience, most significantly in Hong Kong, Singapore and Malaysia.

g The expense experience variance of £(39) million in 2010 (2009: £(43) million) includes a charge of £(18) million (2009: £(16) million) for expense overruns for operations which are at a relatively early stage of development, for which actual expenses are in excess of those factored into the product pricing. Also included in 2010 is £(9) million arising in Taiwan (2009: £(8) million) reflecting over-runs whilst the business rebuilds scale following the sale of the Agency business and in 2009, an expense variance of £(10) million arose in Korea, reflecting the lower level of sales in the period.

h The negative persistency experience variance of £(48) million in 2010 mainly arises in India of £(27) million relating to higher paid-ups and surrenders on unit-linked business and in Malaysia of £(26) million for higher partial withdrawals on unit-linked business as customers sought to monetise a proportion of their funds following two years of exceptional returns.

The charge of £(76) million in 2009 relating to negative persistency experience arises across the region with the largest impacts in Korea (£(29) million), India (£(11) million) and Japan (£(9) million).

i The credit of £41 million in 2010 for other experience and other items includes a credit of £24 million arising in Indonesia for the impact of additional riders being added to in-force policies during the year, funded from the policyholder unit linked account balances.

j The in-force operating profit for 2010 of £549 million reflects the effect of setting economic assumptions on an 'active' basis rather than the previously applied 'passive' basis as described in note 1(b), the impact of which was to lower in-force operating profits in 2010 by £58 million, principally for altered unwind of discount.

ii US operations

| | **2010** | 2009 |
|---|---|---|
| | **£m** | £m |
| Unwind of discount and other expected returns[a] | **369** | **344** |
| Effect of changes in operating assumptions: | | |
| Guaranteed Minimum Withdrawal Benefit (GMWB) policyholder behaviour[b] | **-** | **156** |
| Mortality[c] | **10** | **33** |
| Variable Annuity (VA) fees[d] | **27** | **(13)** |
| Other[e] | **(34)** | **(75)** |
| | **3** | **101** |
| Experience variances and other items: | | |
| Spread experience variance[f] | **158** | **(3)** |
| Amortisation of interest-related realised gains and losses[g] | **82** | **59** |
| Expense[h] | **32** | **40** |
| Mortality[i] | **21** | **32** |
| Persistency[j] | **23** | **7** |
| Other | **9** | **(11)** |
| | **325** | **124** |
| Total US operations | **697** | **569** |

**Notes**

a The increase in unwind of discount and other expected returns from £344 million for 2009 to £369 million for 2010 primarily represents an increase in the return on net worth arising from a higher opening value between 1 January 2009 and 1 January 2010.

b The positive impact of the change in GMWB policyholder behaviour assumptions of £156 million for 2009 reflects the altered assumptions relating to the utilisation of withdrawal features available to policyholders on Variable Annuity (VA) contracts which have been modified to take account of the more recent experience of policyholder behaviour when benefits are 'in the money'. Previously, policyholder behaviour for the utilisation of GMWB was assumed to be largely driven by the extent to which benefits were in the money. For 2009, the assumption was altered to take account of recent experience which shows that the attained age of the policyholder is the key factor in determining utilisation levels.

c The credit of £10 million for updates to mortality assumptions in 2010 represents a credit of £29 million for business other than variable annuity, reflecting recent experience, partially offset by a negative effect on variable annuity business of £(19) million for a change in the modelling of mortality rates. The £33 million credit for mortality in 2009 primarily reflects lower mortality rates for the Life of Georgia business, based upon actual experience since the acquisition of the business in 2005.

d The effect of the change of assumption for VA fees represents the capitalised value of the change in the projected level of policyholder advisory fees, which vary according to the size and mix of VA funds. The credit of £27 million for 2010 reflects an increase in the projected level of fees paid by policyholders, according to the current fund mix. The negative effect of the change in 2009 of £(13) million represents a reduction in the level of fees.

e The charge of £(34) million for other operating assumption changes in 2010 includes a credit of £4 million for the overall effect of changes to persistency assumptions and the net effect of a number of items including a charge of £(19) million for the altered projection of life reserves run-off. The effect of other changes in assumptions in 2009 of £(75) million primarily represents the negative impact of changes in persistency assumptions of £(53) million, reflecting an increase in the assumed utilisation of the partial withdrawal option on Variable and Fixed Annuity business of £(29) million and £(24) million for the effect of other altered lapse rates, in line with experience.

f The spread assumption for Jackson is determined on a longer-term basis, net of provision for defaults. The spread experience variance in 2010 is a positive £158 million, arising principally from transactions undertaken in the year to more closely match the overall asset and liability duration the effect of which is expected to persist in 2011 but at a reduced level.

g The amortisation of interest-related gains and losses reflects the same treatment applied to the supplementary analysis of IFRS profit. When bonds that are neither impaired nor deteriorating are sold and reinvested there will be a consequent change in the investment yield. The realised gain or loss is amortised into the result over the period when the bonds would have otherwise matured to better reflect the long-term returns included in operating profits. The increase in amortisation of interest-related gains and losses from £59 million in 2009 to £82 million in 2010 reflects the increased level of realised gains in the second half of 2009, on which a full year's amortisation is recognised in 2010.

h The positive expense experience variance of £32 million (2009: £40 million) primarily represents favourable experience variance relating to marketing expenses.

i The positive mortality experience variance of £21 million (2009: £32 million) primarily relates to life products.

j The positive persistency experience variance of £23 million primarily arises from favourable experience on annuity and institutional business.

iii UK insurance operations

| | 2010 £m | 2009 £m |
|---|---|---|
| Unwind of discount and other expected returns[a] | **550** | 588 |
| Effect of changes in operating assumptions: | | |
| Updated mortality assumptions, net of release of margins[b] | **(40)** | - |
| Expense[c] | **37** | - |
| | **(3)** | - |
| Effect of change in UK corporate tax rate[d] | **41** | - |
| Other items[e] | **(17)** | 52 |
| Total UK insurance operations | **571** | 640 |

**Notes**

a The decrease in unwind of discount and other expected returns from 2009 of £588 million to £550 million in 2010 mainly arises from the impact of the reduction in discount rates, reflecting the decrease in gilt rates of 0.4 per cent.

b The Continuous Mortality Investigation (CMI) model and Core Projection parameters have been reviewed and a custom parameterisation of the CMI model has been made where some aspects of the pattern of convergence from current rates of improvements to long-term rates of improvement have been altered. The assumption change shown above of a charge of £(40) million represents the effect of the implementation of the custom parameterisation on the opening value of in-force business at 1 January 2010, offset by the effects of other mortality assumption changes and the release of margins on the base mortality assumptions.

c The credit of £37 million in 2010 for changes in operating expense assumptions relates to renewal expense assumptions on shareholder backed annuity business.

d At 31 December 2010 a change to reduce the UK corporate tax rate from 28 per cent to 27 per cent with effect from 1 April 2011 had been enacted in the legislative process. The effect of the change in the corporate tax rate of £41 million represents the pre-tax benefit arising from the change in projecting the tax cash flows attaching to in-force business.

e The credit of £52 million in 2009 includes a credit of £22 million for the effects of rebalancing the UK annuity business asset portfolio backing the liabilities to policyholders, reflecting the altered value arising from the revised projected yield and allowances for default risk.

## 4 Short-term fluctuations in investment returns

Short-term fluctuations in investment returns, net of the related change in the time value of cost of options and guarantees, arise as follows:

| | 2010 £m | 2009 £m |
|---|---|---|
| Insurance operations: | | |
| Asia[note i] | **287** | 437 |
| US[note ii] | **(678)** | (401) |
| UK[note iii] | **336** | 445 |
| Other operations: | | |
| IGD hedge costs[note iv] | **-** | (235) |
| Other[note v] | **25** | 105 |
| Total | **(30)** | 351 |

**Notes**

i Asian operations

| | 2010 £m | 2009 £m |
|---|---|---|
| Indonesia | **55** | 40 |
| Hong Kong | **51** | 113 |
| Taiwan | **40** | 20 |
| Malaysia | **37** | 40 |
| Singapore | **16** | 159 |
| Other operations | **88** | 65 |
| | **287** | 437 |

For 2010 short-term fluctuations for Asian operations of £287 million primarily reflect the favourable performance in equity markets across the territories. The short-term fluctuations for other operations in 2010 of £88 million include an unrealised gain of £30 million on the Group's 8.66 per cent stake in China Life Insurance Company of Taiwan, which at 31 December 2010 was valued at £100 million. For 2009, the short-term fluctuations in investment returns in Asia of £437 million reflect the effect of strong equity market performance in particular for participating business and unit-linked business where the in-force value benefits from increases in shareholder transfers and from the capitalisation of increased projected fees due to the higher asset base at the end of the year.

ii US operations

The fluctuations for US operations comprise the following items:

| | 2010 £m | 2009 £m |
|---|---|---|
| Actual realised losses less default assumption and amortisation of interest-related gains and losses for fixed income securities and related swap transactions[a] | **(351)** | (367) |
| Actual less long-term return on equity based investments and other items[b] | **5** | (144) |
| Investment return related (loss) gain due primarily to changed expectation of profits on in-force variable annuity business in future periods based on current period equity returns, net of related hedging activity for equity related products[c] | **(332)** | 110 |
| | **(678)** | (401) |

**Notes**

a The charges relating to fixed income securities for 2010 of £(351) million and 2009 of £(367) million shown above primarily represent the excess of credit-related losses in the year on the US statutory basis over the amortisation of interest-related gains and longer-term default assumption included within operating profit, together with for 2010, the impact of de-risking activities within the portfolio.

b The charge in 2009 of £(144) million for actual less long-term return on equity based investments and other items primarily relates to the shortfall of actual return against the expected return on investments in limited partnerships.

c This item arises due to the market returns, net of related hedging activity, being higher or lower than the assumed longer-term rate of return. This gives rise to higher or lower than expected period end values of variable annuity assets under management with a resulting effect on the projected value of future account values and hence future profitability from altered fees. For 2010 the US equity market returns were 14.5 per cent compared to the assumed longer-term rate of 6.8 per cent for the period which was more than offset by the impact of hedging activity. For 2009 the US equity market returns were approximately 24 per cent compared to the assumed longer-term rate of 7.4 per cent for the period.

iii UK insurance operations

The short-term fluctuations in investment returns for UK insurance operations represents:

| | **2010** | 2009 |
|---|---|---|
| | **£m** | £m |
| With-profits[a] | **218** | 430 |
| Shareholder-backed annuity[b] | **84** | (40) |
| Unit-linked and other[c] | **34** | 55 |
| | **336** | 445 |

**Notes**

a For with-profits business the credit for 2010 of £218 million reflects the positive 12.0 per cent actual investment return on the investments of the PAC with-profits fund (covering policyholder liabilities and unallocated surplus) against the assumed long-term rate of 6.7 per cent. The credit of £430 million for 2009 reflects the positive variance of 8.6 per cent against the assumed long-term investment return.

b Short-term fluctuations in investment returns for shareholder-backed annuity business include gains (losses) on surplus assets relative to the expected return due to a fall (rise) in yields, the difference between actual and expected default experience and mismatching profits and losses arising from the impacts of changes in yields on assets and liabilities of differing durations. The short-term fluctuations in investment returns for 2010 of a credit of £84 million represent better than expected default experience of £64 million, higher than expected gains arising on surplus assets of £55 million, partially offset by mismatching losses of £(21) million, and other impacts of £(14) million. The charge of £(40) million for 2009 represents mismatching losses of £(105) million, partially offset by better than expected default experience of £22 million with the remaining balance of £43 million consisting of positive movements in other asset values partially offset by losses on surplus assets.

c The credit of £34 million for 2010 (2009: credit of £55 million) primarily relates to unit-linked business representing the increase in capitalised value of future fees arising from the positive movements in market values experienced during the relevant reporting periods.

iv IGD hedge costs

During the severe equity market conditions experienced in the first quarter of 2009, coupled with historically high equity volatility, the Group entered into exceptional short-dated hedging contracts to protect against potential tail-events on the IGD capital position, in addition to the regular operational hedging programmes. The hedge contracts have expired and have not been renewed.

v Other operations

Short-term fluctuations in investment returns of other operations, in addition to the previously discussed IGD hedge costs for 2009, arise from:

| | **2010** | 2009 |
|---|---|---|
| | **£m** | £m |
| Unrealised value movements on swaps held centrally to manage Group assets and liabilities | **(25)** | 28 |
| Unrealised value movements on Prudential Capital bond portfolio | **48** | 66 |
| Unrealised value movements on investments held by other operations | **2** | 11 |
| | **25** | 105 |

## 5 Effect of changes in economic assumptions

The effects of changes in economic assumptions for in-force business, net of the related change in the time value of cost of options and guarantees, included within the profit from continuing operations before tax (including actual investment returns) arise as follows:

| | **2010** | 2009 |
|---|---|---|
| | **£m** | £m |
| Asian operations[note i] | **(71)** | (174) |
| US operations[note ii] | **(1)** | (518) |
| UK insurance operations[note iii] | **62** | (218) |
| Total | **(10)** | (910) |

**Notes**

i The charge of £(71) million in Asian operations for the effect of changes in economic assumptions in 2010 primarily represents the effect of derisking certain asset portfolios in Hong Kong and Singapore of £(73) million, together with the impact of the reduction in fund earned rates and risk discount rates as shown in note 16(a), including the effect of altering the basis of setting economic assumptions to the ‘active’ basis as described in note 1(b). The charge for 2009 of £(174) million primarily reflects increases in risk discount rates and fund earned rates, with the largest impact arising for Hong Kong US dollar denominated business arising from the increase in US dollar government bond yields, partly offset by a credit of £96 million for the effect of altered economic assumptions for Indonesia and Korea arising from a change in the application of the Group’s methodology for these operations (as discussed in note 16a).

ii The charge of £(1) million for the effect of changes in economic assumptions, net of the related change in the time value of cost of options and guarantees, for US operations for 2010 reflects the following:

| | **2010 £m** | 2009 £m |
|---|---|---|
| Effect of changes in treasury rates, beta and equity risk premium:[a] | | |
| Fixed annuity and other general account business | **111** | (398) |
| Variable Annuity (VA) business | **(112)** | 181 |
| Increase in risk margin allowance for credit risk[b] | **-** | (301) |
| | **(1)** | (518) |

**Notes**

a For Jackson, the charge for the effect of changes in economic assumptions represents the aggregate of the effects of changes to projected returns and the risk discount rate. The risk discount rate, as discussed in note 1b(iii), represents the aggregate of the risk-free rate and margin for market risk, credit risk and non-diversifiable non-market risk.
For fixed annuity and other general account business the effect of changes to the risk-free rate, which is defined as the 10-year treasury rate, is reflected in the risk discount rate. This discount rate is in turn applied to projected cash flows which principally reflect projected spread, which is largely insensitive to changes in the risk-free rate. Secondary effects on the cash flows also result from changes to assumed future yield and resulting policyholder behaviour. For VA business, changes to the risk-free rate are also reflected in determining the risk discount rate. However, the projected cash flows are also reassessed for altered investment returns on the underlying separate account assets from which fees are charged. For 2010, the effect of these changes resulted in an overall credit for fixed annuity and other general account business of £111 million and a charge of £(112) million for VA business reflecting the reduction of 0.6 per cent in the risk-free rate (as shown in note 16a).
For 2009, the effect of these changes resulted in an overall charge for fixed annuity and other general account business of £(398) million and an overall credit on VA business of £181 million, reflecting the increase in the risk-free rate of 1.6 per cent.

b For 2010 and 2009, the Group has included an additional allowance for credit risk. In determining this allowance a number of factors were considered. These factors, in particular, include:
i How much of the credit spread on debt securities represents an increased credit risk not reflected in the Risk Margin Reserve (RMR) long-term default assumptions, and how much is liquidity premium. In assessing this effect consideration has been given to a number of approaches to estimating the liquidity premium by considering statistical data over the four years from 2006 to 2009, and
ii Policyholder benefits for Jackson fixed annuity business are not fixed. It is possible in adverse economic scenarios to pass on a component of credit loss to policyholders (subject to guarantee features) through lower crediting rates. Consequently, it is only necessary to allow for the balance of the credit risk in the risk discount rate.
After taking these and other more detailed factors into account and, based on market conditions in late 2009, the risk discount rate for general account business was increased by 150 basis points as an additional allowance for credit risk. For VA business, the additional allowance increase was set at 20 per cent of the non-VA business increase to reflect the fact that a proportion of the VA business is allocated to general account holdings of debt securities. For 2010 these additional allowances have been maintained at 2009 levels. The additional allowance to be applied in future reporting periods will be altered, as necessary, for future credit conditions and as the business in force alters over time.

iii The effect of changes in economic assumptions, net of the related change in the time value of cost of options and guarantees, of a credit of £62 million for UK insurance operations for 2010 comprises the effect of:

| | **2010 £m** | | | 2009 £m | | |
|---|---|---|---|---|---|---|
| | **Shareholder-backed annuity business** note a | **With-profits and other business** note b | **Total** | Shareholder-backed annuity business note a | With-profits and other business note b | Total |
| (Decrease) increase in expected long-term rates of return | **(102)** | **(80)** | **(182)** | (284) | 191 | (93) |
| Decrease (increase) in risk discount rates | **55** | **183** | **238** | 240 | (311) | (71) |
| Other changes | **(6)** | **12** | **6** | 25 | (79) | (54) |
| | **(53)** | **115** | **62** | (19) | (199) | (218) |

**Notes**

a For 2010, the effects of decreases in expected long-term rates of return and risk discount rates for shareholder-backed annuity business primarily reflect the reduction in gilt rates of 0.4 per cent, as shown in note 16a. In 2009, the overall charge of £(19) million reflects the effects of regular economic assumption changes. However, the amounts for the component line items shown above reflect a change in the composition of the default allowance between best estimate levels (which are reflected in the long-term rates of return) and allowance for credit risk premium and additional short-term defaults reflected in the risk discount rate.

b For 2010, the credit of £115 million for with-profits and other business reflects a decrease in risk discount rates which more than offsets the reduction in fund earned rates, primarily driven by the decrease in gilt rates of 0.4 per cent in the year. In 2009, the charge of £(199) million for with-profits and other business reflects the fact that the risk discount rate has increased significantly more than the earned rate as a result of the revised correlation assumptions, lower equity backing ratio and very low cash return.

## 6 Costs of terminated AIA transaction

The following costs were incurred in relation to the proposed and subsequently terminated transaction, to purchase AIA Group Limited and related rights issue.

| | **2010 £m** |
|---|---|
| AIG termination break fee | **153** |
| Underwriting fees | **58** |
| Costs associated with foreign exchange hedging | **100** |
| Adviser fees and other | **66** |
| Total costs before tax | **377** |
| Associated tax relief | **(93)** |
| **Total costs after tax** | **284** |

## 7 Shareholders' funds (excluding non-controlling interests) - segmental analysis

| | Note | 2010 £m | 2009 £m |
|---|---|---|---|
| **Asian operations** | | | |
| Long-term business: | | | |
| Net assets of operations – EEV basis shareholders' funds[note iv] | | **7,445** | 5,781 |
| Acquired goodwill[note iii] | | **236** | 80 |
| | | **7,681** | 5,861 |
| Asset management:[note i] | | | |
| Net assets of operations | | **197** | 161 |
| Acquired goodwill | | **61** | 61 |
| | | **258** | 222 |
| | | **7,939** | 6,083 |
| **US operations** | | | |
| Jackson – EEV basis shareholders' funds (net of surplus note borrowings of £172 million (2009: £158 million) [note 9]) | | **4,799** | 4,122 |
| Broker-dealer and asset management operations[note i] | | | |
| Net assets of operations | | **106** | 95 |
| Acquired goodwill | | **16** | 16 |
| | | **122** | 111 |
| | | **4,921** | 4,233 |
| **UK operations** | | | |
| Insurance operations: | | | |
| Long-term business operations: | | | |
| Smoothed shareholders' funds | | **5,911** | 5,547 |
| Actual shareholders' funds less smoothed shareholders' funds | | **59** | (108) |
| EEV basis shareholders' funds | | **5,970** | 5,439 |
| Other[note i] | | **33** | 37 |
| | | **6,003** | 5,476 |
| M&G:[note i] | | | |
| Net assets of operations | | **254** | 173 |
| Acquired goodwill | | **1,153** | 1,153 |
| | | **1,407** | 1,326 |
| | | **7,410** | 6,802 |
| **Other operations** | | | |
| Holding company net borrowings at market value | 9 | **(2,212)** | (1,780) |
| Other net assets (liabilities)[note i] | | **149** | (65) |
| | | **(2,063)** | (1,845) |
| Total | | **18,207** | 15,273 |

| **Representing:** | **2010 £m** | | | 2009 £m | | |
|---|---|---|---|---|---|---|
| | **Statutory IFRS basis shareholders' equity** | **Additional retained profit on an EEV basis** | **EEV basis shareholders' equity** | Statutory IFRS basis shareholders' equity | Additional retained profit on an EEV basis | EEV basis shareholders' equity |
| Asian operations | **2,149** | **5,532** | **7,681** | 1,462 | 4,399 | 5,861 |
| US operations | **3,815** | **984** | **4,799** | 3,011 | 1,111 | 4,122 |
| UK insurance operations | **2,115** | **3,855** | **5,970** | 1,902 | 3,537 | 5,439 |
| Total long-term business operations | **8,079** | **10,371** | **18,450** | 6,375 | 9,047 | 15,422 |
| Other operations[note ii] | **(48)** | **(195)** | **(243)** | (104) | (45) | (149) |
| Group total | **8,031** | **10,176** | **18,207** | 6,271 | 9,002 | 15,273 |

**Notes**

i With the exception of the share of the Prudential Staff Pension Scheme (PSPS) deficit attributable to the PAC with-profits fund, which is included in 'Other operations' net assets (liabilities), these amounts have been determined on the statutory IFRS basis. The overall pension scheme deficit, net of tax, attributable to shareholders relating to PSPS is determined as shown below:

| | 2010 £m | 2009 £m |
|---|---|---|
| IFRS basis deficit (relating to shareholder-backed operations) | **(10)** | (16) |
| Additional EEV deficit (relating to shareholders' 10 per cent share of the IFRS basis deficit attributable to the PAC with-profits fund) | **(3)** | (5) |
| EEV basis | **(13)** | (21) |

ii The additional retained profit on an EEV basis for Other operations represents the mark to market value difference on holding company net borrowings of a charge of £(177) million (2009: charge of £(26) million) and the effect of accounting for pension costs for the Prudential Staff Pension Scheme.

iii The increase in acquired goodwill for Asian long-term business operations from £80 million in 2009 to £236 million in 2010 represents £141 million arising from the acquisition of United Overseas Bank Life Assurance Limited (as shown in note 17) and £15 million for exchange rate movements.

iv The EEV basis shareholders' funds for Asian long-term business of £7,445 million for 2010 have been determined after including the £(39) million effect of moving from a passive to an active basis of economic assumption setting, as described in note 1b.

## 8 Analysis of movement in free surplus

Free surplus is the excess of the net worth over the capital required to support the covered business. Where appropriate, adjustments are made to the regulatory basis net worth from the local regulatory basis so as to include backing assets movements at fair value rather than cost so as to comply with the EEV Principles. Prudential has based required capital on its internal targets for economic capital subject to it being at least the local statutory minimum requirements, as described in note 1b(ii).

| | 2010 £m | | |
|---|---|---|---|
| **Long-term business and asset management operations** note i | **Long-term business** note 13 | **Asset management and UK general insurance commission** note ii | **Free surplus of long-term business, asset management and UK general insurance commission** |
| Underlying movement: | | | |
| New business: | | | |
| Excluding Japan | **(643)** | **-** | **(643)** |
| Japan | **(2)** | **-** | **(2)** |
| Total | **(645)** | **-** | **(645)** |
| Business in force: | | | |
| Expected in-force cash flows (including expected return on net assets) | **1,829** | **310** | **2,139** |
| Effects of changes in operating assumptions, operating experience variances and other operating items | **220** | **-** | **220** |
| | **1,404** | **310** | **1,714** |
| Changes in non-operating items note iii | **(120)** | **26** | **(94)** |
| | **1,284** | **336** | **1,620** |
| Net cash flows to parent company note iv | **(735)** | **(200)** | **(935)** |
| Exchange movements, timing differences and other items note v | **134** | **(12)** | **122** |
| **Net movement in free surplus** | **683** | **124** | **807** |
| Balance at 1 January 2010 | **2,065** | **466** | **2,531** |
| **Balance at 31 December 2010** | **2,748** | **590** | **3,338** |
| Representing: | | | |
| Asian operations | **1,045** | **197** | **1,242** |
| US operations | **1,163** | **106** | **1,269** |
| UK operations | **540** | **287** | **827** |
| | **2,748** | **590** | **3,338** |
| 1 January 2010 | | | |
| Representing: | | | |
| Asian operations | 801 | 161 | 962 |
| US operations | 749 | 95 | 844 |
| UK operations | 515 | 210 | 725 |
| | 2,065 | 466 | 2,531 |

**Notes**

i All figures are shown net of tax.

ii For the purposes of this analysis, free surplus for asset management operations and the UK general insurance commission is taken to be IFRS basis shareholders' funds as shown in note 7.

iii Changes in non-operating items
This represents short-term fluctuations in investment returns, the shareholders' share of actuarial and other gains and losses on defined benefit pension schemes and the effect of changes in economic assumptions for long-term business operations.
Short-term fluctuations in investment returns primarily reflect temporary market movements on the portfolio of investments held by the Group's shareholder-backed operations together with the shareholders' 10 per cent interest in the value movements on the assets in the with-profits funds.

iv Net cash flows to parent company for long-term business operations reflect the flows as included in the holding company cash flow at transaction rates.

v Exchange movements, timing differences and other items represent:

| | 2010 £m | | |
|---|---|---|---|
| | **Long-term business** | **Asset management and UK general insurance commission** | **Total** |
| Exchange movements note 13 | 78 | 18 | 96 |
| Mark to market value movements on Jackson assets backing surplus and required capital note 13 | 68 | - | 68 |
| Other | (12) | (30) | (42) |
| | 134 | (12) | 122 |

## 9 Net core structural borrowings of shareholder-financed operations

| | 2010 £m | | | 2009 £m | | |
|---|---|---|---|---|---|---|
| | **IFRS basis** | **Mark to market value adjustment** note ii | **EEV basis at market value** | IFRS basis | Mark to market value adjustment note ii | EEV basis at market value |
| Holding company* cash and short-term investments | **(1,232)** | **-** | **(1,232)** | (1,486) | - | (1,486) |
| Core structural borrowings – central funds[note i] | **3,267** | **177** | **3,444** | 3,240 | 26 | 3,266 |
| Holding company net borrowings | **2,035** | **177** | **2,212** | 1,754 | 26 | 1,780 |
| Core structural borrowings – PruCap[note iii] | **250** | **-** | **250** | - | - | - |
| Core structural borrowings – Jackson | **159** | **13** | **172** | 154 | 4 | 158 |
| Net core structural borrowings of shareholder-financial operations | **2,444** | **190** | **2,634** | 1,908 | 30 | 1,938 |

*Including central finance subsidiaries.

**Notes**

i EEV basis holding company borrowings comprise:

| | **2010 £m** | 2009 £m |
|---|---|---|
| Perpetual subordinated capital securities (Innovative Tier 1) | **1,491** | 1,351 |
| Subordinated debt (Lower Tier 2) | **1,372** | 1,372 |
| Senior debt | **581** | 543 |
| | **3,444** | 3,266 |

In May 2009, the Company repaid maturing £249 million senior debt and in the same month the Company issued £400 million subordinated notes in part to replace the maturing debt.
In July 2009, the Company issued US$750 million perpetual subordinated capital securities.

In accordance with the EEV Principles, core borrowings are carried at market value. As the liabilities are generally held to maturity or for the long-term, no deferred tax asset or liability has been established on the market value adjustment above.

ii The movement in the mark to market value adjustment represents:

| Mark to market movement in balance sheet: | **2010 £m** | 2009 £m |
|---|---|---|
| Beginning of year | **30** | (821) |
| Change: | | |
| Income statement | **164** | 795 |
| Foreign exchange effects | **(4)** | 56 |
| End of year | **190** | 30 |

iii The £250 million PruCap bank loan was made in two tranches: £135 million maturing in June 2014 and £115 million maturing in August 2012.

## 10 Reconciliation of movement in shareholders' funds (excluding non-controlling interests)

| | 2010 £m | | | | | |
|---|---|---|---|---|---|---|
| | Long-term business operations | | | | | |
| | Asian operations | US operations | UK insurance operations | Total long-term business | Other operations | Group Total |
| **Operating profit (based on longer-term investment returns)** | | | | | | |
| Long-term business: | | | | | | |
| New business: | | | | | | |
| Excluding Japan[note 2] | 902 | 761 | 365 | 2,028 | - | 2,028 |
| Japan | (1) | - | - | (1) | - | (1) |
| Total | 901 | 761 | 365 | 2,027 | - | 2,027 |
| Business in force[note 3] | 549 | 697 | 571 | 1,817 | - | 1,817 |
| | 1,450 | 1,458 | 936 | 3,844 | - | 3,844 |
| Asia development expenses | (4) | - | - | (4) | - | (4) |
| UK general insurance commission | - | - | - | - | 46 | 46 |
| M&G | - | - | - | - | 284 | 284 |
| Asian asset management operations | - | - | - | - | 72 | 72 |
| US broker-dealer and asset management | - | - | - | - | 22 | 22 |
| Other income and expenditure | - | - | - | - | (494) | (494) |
| Solvency II implementation costs | - | (4) | (7) | (11) | (35) | (46) |
| Restructuring costs | - | - | (28) | (28) | - | (28) |
| **Operating profit based on longer-term investment returns** | 1,446 | 1,454 | 901 | 3,801 | (105) | 3,696 |
| Short-term fluctuations in investment returns[note 4] | 287 | (678) | 336 | (55) | 25 | (30) |
| Mark to market value movements on core borrowings[note 9] | - | (9) | - | (9) | (155) | (164) |
| Shareholders' share of acturial and other gains and losses on defined benefit pension schemes | - | - | (5) | (5) | (6) | (11) |
| Effect of changes in economic assumptions[note 5] | (71) | (1) | 62 | (10) | - | (10) |
| Cost of terminated AIA transaction[note 6] | - | - | - | - | (377) | (377) |
| Gain on dilution of holding in PruHealth[note 18] | - | - | 3 | 3 | - | 3 |
| **Profit (loss) from continuing operations before tax (including actual investment returns)** | 1,662 | 766 | 1,297 | 3,725 | (618) | 3,107 |
| Tax (charge) credit attributable to shareholders' profit (loss):[note 11] | | | | | | |
| Tax on operating profit[note iii] | (329) | (509) | (260) | (1,098) | 264 | (834) |
| Tax on short-term fluctuations in investment returns | (12) | 325 | (91) | 222 | - | 222 |
| Tax on shareholders' share of actuarial and other gains and losses on defined pension schemes | - | - | - | - | 2 | 2 |
| Tax on effect of changes in economic assumptions | 4 | - | (17) | (13) | - | (13) |
| Tax on costs of terminated AIA transaction[note 6] | - | - | - | - | 93 | 93 |
| Total tax (charge) credit | (337) | (184) | (368) | (889) | 359 | (530) |
| Non-controlling interests | - | - | - | - | (4) | (4) |
| **Profit (loss) for the year** | 1,325 | 582 | 929 | 2,836 | (263) | 2,573 |
| Exchange movements on foreign operations and net investment hedges[note i] | 530 | 124 | - | 654 | 5 | 659 |
| Related tax | - | - | - | - | 34 | 34 |
| Intra-group dividends (including statutory transfer)[note v] | (365) | (81) | (398) | (844) | 844 | - |
| External dividends | - | - | - | - | (511) | (511) |
| Reserve movements in respect of share-based payments | - | - | - | - | 37 | 37 |
| Acquisition of UOB Life[notes iv and 17] | 79 | - | - | 79 | (79) | - |
| Investment in operations[note v] | 103 | - | 21 | 124 | (124) | - |
| Other transfers[note vi] | (8) | (16) | (21) | (45) | 45 | - |
| Movement in own shares held in respect of share-based payment plans | - | - | - | - | (4) | (4) |
| Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS | - | - | - | - | 3 | 3 |
| New share capital subscribed | - | - | - | - | 75 | 75 |
| Mark to market value movements on Jackson assets backing surplus and required capital (net of related tax of £37 million)[note 13] | - | 68 | - | 68 | - | 68 |
| Net increase in shareholders' equity | 1,664 | 677 | 531 | 2,872 | 62 | 2,934 |
| Shareholders' equity at 1 January 2010[notes ii and 7] | 5,781 | 4,122 | 5,439 | 15,342 | (69) | 15,273 |
| **Shareholders' equity at 31 December 2010**[notes ii and 7] | 7,445 | 4,799 | 5,970 | 18,214 | (7) | 18,207 |

**Notes**

i Profits are translated at average exchange rates, consistent with the method applied for statutory IFRS basis results. The amounts recorded above for exchange rate movements reflect the difference between 2010 and 2009 exchange rates as applied to shareholders' funds at 1 January 2010 and the difference between 31 December 2010 and average 2010 rates for profits.

ii For the purposes of the table above, goodwill related to Asia long-term operations (as shown in note 7) is included in Other operations.

iii The tax charge attributable to shareholders profit includes an exceptional tax credit of £158 million as detailed in note 11 ii.

iv The charge of £(79) million for Other operations relating to the acquisition of UOB Life represents cash consideration paid of £(220) million offset by goodwill arising on the acquisition of £141 million (as shown in note 17).

v Total intra-group dividends and investment in operations represent:

| | Asian operations £m | US operations £m | UK insurance operations £m | Total long-term business operations £m | Other operations £m | Total £m |
|---|---|---|---|---|---|---|
| Intra-group dividends (including statutory transfer) | **(365)** | **(81)** | **(398)** | **(844)** | **844** | **-** |
| Investment in operations[a] | **103** | **-** | **21** | **124** | **(124)** | **-** |
| Total[b] | **(262)** | **(81)** | **(377)** | **(720)** | **720** | **-** |

a Investment in operations reflects increases in share capital.

b For long-term business operations, the difference between the total above of £(720) million for intra-group dividends (including statutory transfer) and investment in operations and the net cash flows to parent company of £(735) million (as shown in note 8) primarily relates to timing differences, intra-group loans and other non-cash items.

vi Other transfers from long-term business operations to Other operations in 2010 represent:

| | Asian operations £m | US operations £m | UK insurance operations £m | Total long-term business operations £m |
|---|---|---|---|---|
| Adjustment for net of tax asset management projected profits of covered business | **(11)** | **(3)** | **(20)** | **(34)** |
| Other adjustments | **3** | **(13)** | **(1)** | **(11)** |
| | **(8)** | **(16)** | **(21)** | **(45)** |

## 11 Tax attributable to shareholders' profit

The tax charge (credit) comprises:

| | 2010 £m | 2009 £m |
|---|---|---|
| **Tax charge on operating profit based on longer-term investment returns:** | | |
| Long-term business: | | |
| Asian operations[note i] | **329** | 239 |
| US operations | **509** | 416 |
| UK insurance operations[note i] | **260** | 245 |
| | **1,098** | 900 |
| Other operations | **(106)** | (34) |
| Total tax charge on operating profit based on longer-term investment returns, excluding exceptional tax credit | **992** | 866 |
| Exceptional tax credit[note ii] | **(158)** | - |
| **Total tax charge on operating profit based on longer-term investment returns, including exceptional tax credit[note ii]** | **834** | 866 |
| **Tax credit on items not included in operating profit:** | | |
| Tax credit on short-term fluctuations in investment returns[note iii] | **(222)** | (26) |
| Tax credit on shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | **(2)** | (23) |
| Tax charge (credit) on effect of changes in economic assumptions | **13** | (336) |
| Tax credit on costs of terminated AIA transaction | **(93)** | - |
| Total tax credit on items not included in operating profit | **(304)** | (385) |
| **Tax charge on profit on ordinary activities from continuing operations (including tax on actual investment returns)** | **530** | 481 |

**Notes**

i Including tax relief on Asia development expenses and restructuring costs borne by UK insurance operations.

ii The tax charge on operating profit based on longer-term investment returns in 2010 of £834 million includes an exceptional tax credit of £158 million which primarily relates to the impact of the settlement agreed with the UK tax authorities.

iii The tax charge on short-term fluctuations in investment returns for 2010 of £(222) million includes a credit of £52 million for a net present value reduction in US deferred tax liabilities following changes to variable annuity reserving in accordance with revised statutory guidance.

## 12 Earnings per share (EPS)

| | 2010 £m | 2009 £m |
|---|---|---|
| Operating EPS: | | |
| Operating profit before tax | **3,696** | 3,090 |
| Tax excluding exceptional tax credit | **(992)** | (866) |
| Non-controlling interests | **(4)** | (3) |
| Operating profit after tax and non-controlling interests excluding exceptional tax credit | **2,700** | 2,221 |
| Exceptional tax credit* | **158** | - |
| Operating profit after tax and non-controlling interests including exceptional tax credit | **2,858** | 2,221 |
| Operating EPS (pence) excluding exceptional tax credit | **106.9p** | 88.8p |
| Exceptional tax credit (pence) | **6.3p** | - |
| Operating EPS (pence) including exceptional tax credit | **113.2p** | 88.8p |
| | | |
| Total EPS: | | |
| Profit from continuing operations before tax | **3,107** | 1,743 |
| Tax | **(530)** | (481) |
| Discontinued operations (net of tax) | **-** | (14) |
| Non-controlling interests | **(4)** | (3) |
| Total profit after tax and non-controlling interests | **2,573** | 1,245 |
| Total EPS (pence) including exceptional tax credit | **101.9p** | 49.8p |
| Average number of shares (millions) | **2,524** | 2,501 |

The average number of shares reflects the average number in issue adjusted for shares held by employee share trusts and consolidated unit trusts and OEICs which are treated as cancelled.

*The tax charge attributable to shareholders' return includes an exceptional tax credit of £158 million which primarily relates to the impact of a settlement agreed with the UK tax authorities.

## 13 Reconciliation of net worth and value of in-force business[note i]

| | 2010 £m | | | | |
|---|---|---|---|---|---|
| | **Free Surplus** note 8 | **Required capital** | **Total net worth** | **Value of in-force business** note iv | **Total long-term business** |
| **Group** | | | | | |
| **Shareholders' equity at 1 January 2010** | **2,065** | **2,994** | **5,059** | **10,283** | **15,342** |
| New business contribution:[notes ii,iii] | | | | | |
| Excluding Japan | **(643)** | **461** | **(182)** | **1,615** | **1,433** |
| Japan | **(2)** | **-** | **(2)** | **1** | **(1)** |
| Total | **(645)** | **461** | **(184)** | **1,616** | **1,432** |
| Existing business – transfer to net worth | **1,690** | **(372)** | **1,318** | **(1,318)** | **-** |
| Expected return on existing business | **139** | **84** | **223** | **918** | **1,141** |
| Changes in operating assumptions and experience variances | **220** | **(4)** | **216** | **(86)** | **130** |
| Changes in non-operating assumptions, experience variances and non-controlling interests | **(120)** | **85** | **(35)** | **168** | **133** |
| **Profit after tax and non-controlling interests from long-term business** | **1,284** | **254** | **1,538** | **1,298** | **2,836** |
| Exchange movements on foreign operations and net investment hedges | **78** | **119** | **197** | **457** | **654** |
| Acquisition of United Overseas Bank (UOB) Life | **18** | **48** | **66** | **13** | **79** |
| Intra-group dividends (including statutory transfer) and investment in operations[note v] | **(720)** | **-** | **(720)** | **-** | **(720)** |
| Mark to market value movements on Jackson assets backing surplus and required capital | **68** | **-** | **68** | **-** | **68** |
| Other transfers from net worth | **(45)** | **-** | **(45)** | **-** | **(45)** |
| **Shareholders' equity at 31 December 2010** | **2,748** | **3,415** | **6,163** | **12,051** | **18,214** |
| **Representing:** | | | | | |
| **Asian operations** | | | | | |
| **Shareholders' equity at 1 January 2010** | 801 | 585 | 1,386 | 4,395 | 5,781 |
| New business contribution:[notes ii,iii] | | | | | |
| Excluding Japan | (278) | 84 | (194) | 866 | 672 |
| Japan | (2) | - | (2) | 1 | (1) |
| Total | (280) | 84 | (196) | 867 | 671 |
| Existing business – transfer to net worth | 500 | 20 | 520 | (520) | - |
| Expected return on existing business | 103 | (9) | 94 | 404 | 498 |
| Changes in operating assumptions and experience variances | 3 | (15) | (12) | (40) | (52) |
| Changes in non-operating assumptions and experience variances and non-controlling interests | 146 | 1 | 147 | 61 | 208 |
| **Profit after tax and non-controlling interests from long-term business** | 472 | 81 | 553 | 772 | 1,325 |
| Exchange movements on foreign operations and net investment hedges | 57 | 76 | 133 | 397 | 530 |
| Acquisition of United Overseas Bank(UOB) Life | 18 | 48 | 66 | 13 | 79 |
| Intra-group dividends (including statutory transfer) and investment in operations[note v] | (295) | - | (295) | 33 | (262) |
| Other transfers from net worth | (8) | - | (8) | - | (8) |
| **Shareholders' equity at 31 December 2010** | 1,045 | 790 | 1,835 | 5,610 | 7,445 |
| **US operations** | | | | | |
| **Shareholders' equity at 1 January 2010** | 749 | 1,405 | 2,154 | 1,968 | 4,122 |
| New business contribution[note ii] | (300) | 270 | (30) | 525 | 495 |
| Existing business – transfer to net worth | 692 | (329) | 363 | (363) | - |
| Expected return on existing business | 31 | 56 | 87 | 153 | 240 |
| Changes in operating assumptions and experience variances | 191 | 18 | 209 | 1 | 210 |
| Changes in non-operating assumptions and experience variances and non-controlling interests | (192) | 42 | (150) | (213) | (363) |
| **Profit after tax and non-controlling interests from long-term business** | 422 | 57 | 479 | 103 | 582 |
| Exchange movements on foreign operations and net investment hedges | 21 | 43 | 64 | 60 | 124 |
| Intra-group dividends (including statutory transfer) and investment in operations | (81) | - | (81) | - | (81) |
| Mark to market value movements on Jackson assets backing surplus and required capital | 68 | - | 68 | - | 68 |
| Other transfers from net worth | (16) | - | (16) | - | (16) |
| **Shareholders' equity at 31 December 2010** | 1,163 | 1,505 | 2,668 | 2,131 | 4,799 |

| | 2010 £m | | | | |
|---|---|---|---|---|---|
| | **Free Surplus** note 8 | **Required capital** | **Total net worth** | **Value of in-force business** note iv | **Total long-term business** |
| **UK insurance operations** | | | | | |
| **Shareholders' equity at 1 January 2010** | 515 | 1,004 | 1,519 | 3,920 | 5,439 |
| New business contribution[note ii] | (65) | 107 | 42 | 224 | 266 |
| Existing business – transfer to net worth | 498 | (63) | 435 | (435) | - |
| Expected return on existing business | 5 | 37 | 42 | 361 | 403 |
| Changes in operating assumptions and experience variances | 26 | (7) | 19 | (47) | (28) |
| Changes in non-operating assumptions and experience variances and non-controlling interests | (74) | 42 | (32) | 320 | 288 |
| **Profit after tax and non-controlling interests from long-term business** | 390 | 116 | 506 | 423 | 929 |
| Intra-group dividends (including statutory transfer) and investment in operations [note v] | (344) | - | (344) | (33) | (377) |
| Other transfers from net worth | (21) | - | (21) | - | (21) |
| **Shareholders' equity at 31 December 2010** | 540 | 1,120 | 1,660 | 4,310 | 5,970 |

**Notes**

i All figures are shown net of tax.

ii The movements arising from new business contribution and new business capital usage are as follows:

| | 2010 £m | | | | | |
|---|---|---|---|---|---|---|
| **New business capital usage** | **Asian operations (excluding Japan)** note iii | **US operations** | **UK insurance operations** | **Total long-term business operations** note iii | **Japan** note iii | **Total long-term business operations** |
| Pre-tax new business contribution [note 2] | **902** | **761** | **365** | **2,028** | **(1)** | **2,027** |
| Tax | **(230)** | **(266)** | **(99)** | **(595)** | **-** | **(595)** |
| Post-tax new business contribution | **672** | **495** | **266** | **1,433** | **(1)** | **1,432** |
| Free surplus invested in new business | **(278)** | **(300)** | **(65)** | **(643)** | **(2)** | **(645)** |
| Post-tax new business contribution per £1 million free surplus invested | **2.4** | **1.7** | **4.1** | **2.2** | **(0.5)** | **2.2** |

| | 2009 £m | | | | | |
|---|---|---|---|---|---|---|
| | Asian operations (excluding Japan) note iii | US operations | UK insurance operations | Total long-term business operations note iii | Japan note iii | Total long-term business operations |
| Pre-tax new business contribution[note 2] | 725 | 664 | 230 | 1,619 | (12) | 1,607 |
| Tax | (180) | (232) | (64) | (476) | - | (476) |
| Post-tax new business contribution | 545 | 432 | 166 | 1,143 | (12) | 1,131 |
| Free surplus invested in new business | (231) | (326) | (103) | (660) | (15) | (675) |
| Post-tax new business contribution per £1 million free surplus invested | 2.4 | 1.3 | 1.6 | 1.7 | (0.8) | 1.7 |

| **Movements arising from new business contribution** | **2010 £m** | 2009 £m |
|---|---|---|
| Free surplus invested in new business: | | |
| Excluding Japan | **(643)** | (660) |
| Japan | **(2)** | (15) |
| Total | **(645)** | (675) |
| Required capital | **461** | 451 |
| Total net worth | **(184)** | (224) |
| Value of in-force business | **1,616** | 1,355 |
| Total post tax new business contribution | **1,432** | 1,131 |

iii New business contribution and free surplus invested in new business for the Group's Japanese insurance subsidiary, which ceased selling new business with effect from 15 February 2010, have been presented separately from those of the remainder of the Group.

iv The value of in-force business includes the value of future margins from current in-force business less the cost of holding required capital and represents:

| | 2010 £m | | | |
|---|---|---|---|---|
| | **Asian operations** | **US operations** | **UK insurance operations** | **Group** |
| Value of in-force business before deduction of cost of capital and guarantees | **5,941** | **2,584** | **4,635** | **13,160** |
| Cost of capital[a] | **(321)** | **(183)** | **(236)** | **(740)** |
| Cost of time value of guarantees[b,c] | **(10)** | **(270)** | **(89)** | **(369)** |
| Net value of in-force business | **5,610** | **2,131** | **4,310** | **12,051** |

| | 2009 £m | | | |
|---|---|---|---|---|
| | Asian operations | US operations | UK insurance operations | Group |
| Value of in-force business before deduction of cost of capital and of guarantees | 4,605 | 2,351 | 4,181 | 11,137 |
| Cost of capital | (198) | (175) | (221) | (594) |
| Cost of time value of guarantees | (12) | (208) | (40) | (260) |
| Net value of in-force business | 4,395 | 1,968 | 3,920 | 10,283 |

a The increase in cost of capital for Asian operations from 2009 of £(198) million to £(321) million at 2010 mainly arises from the addition of new business, the effect of changes in economic assumptions resulting from changes in economic factors (including the impact of moving from a 'passive' to 'active' basis as described in note 1b) and the impact of foreign exchange.

b The increase in the cost of time value of guarantees for US operations from 2009 of £(208) million to 2010 of £(270) million primarily relates to Variable Annuity (VA) business, mainly arising from the new business written in the period, reflecting the significant increase in VA sales.

c The increase in the cost of time value of guarantees for UK operations from 2009 of £(40) million to 2010 of £(89) million primarily reflects the effects of short-term fluctuations in investment returns together with the reduction in risk free rate of 0.4 per cent.

v The amounts shown in respect of free surplus and the value of in-force business for Asian and UK operations for intra-group dividends and investment in operations include the impact of contingent loan funding.

## 14 Expected transfer of value of in-force business to free surplus

The discounted value of in-force business and required capital can be reconciled to the 2010 and 2009 totals in the tables below for the emergence of free surplus as follows:

| | **2010 £m** | 2009 £m |
|---|---|---|
| Required capital[note 13] | **3,415** | 2,994 |
| Value of in-force (VIF)[note 13] | **12,051** | 10,283 |
| Add back: deduction for cost of time value of guarantees[note 13] | **369** | 260 |
| Other items[note] | **(845)** | (865) |
| | **14,990** | 12,672 |

**Note**

"Other items" represents deductions for amounts incorporated into VIF where there is no definitive timeframe for when the payments will be made.

In particular, other items includes the deduction of the value of the shareholders' interest in the estate, the value of which is derived by increasing final bonus rates so as to exhaust the estate over the lifetime of the in-force with-profits business. This is an assumption to give an appropriate valuation. To be conservative this item is excluded from the expected free surplus generation profile below.

Cash flows are projected on a deterministic basis and are discounted at the appropriate risk discount rate. The modelled cash flows use the same methodology underpinning the Group's embedded value reporting and so are subject to the same assumptions and sensitivities.

The table below shows how the VIF generated by the in-force business and the associated required capital is modelled as emerging into free surplus over future years.

| | | **2010 £m** | | | | |
|---|---|---|---|---|---|---|
| | | **Expected period of conversion of future post tax distributable earnings and required capital flows to free surplus** | | | | |
| | **2010 Total as shown above** | **1-5 years** | **6-10 years** | **11-15 years** | **16-20 years** | **20+ years** |
| **Asian operations** | **6,329** | **2,304** | **1,407** | **866** | **591** | **1,161** |
| **US operations** | **4,078** | **2,358** | **1,007** | **421** | **173** | **119** |
| **UK insurance operations** | **4,583** | **1,792** | **1,173** | **755** | **468** | **395** |
| **Total** | **14,990** | **6,454** | **3,587** | **2,042** | **1,232** | **1,675** |
| | **100%** | **43%** | **24%** | **14%** | **8%** | **11%** |

| | | 2009 £m | | | | |
|---|---|---|---|---|---|---|
| | | Expected period of conversion of future post tax distributable earnings and required capital flows to free surplus | | | | |
| | 2009 Total as shown above | 1-5 years | 6-10 years | 11-15 years | 16-20 years | 20+ years |
| Asian operations | 4,911 | 1,716 | 1,121 | 687 | 455 | 932 |
| US operations | 3,739 | 2,129 | 980 | 364 | 153 | 113 |
| UK insurance operations | 4,022 | 1,591 | 1,035 | 653 | 401 | 342 |
| Total | 12,672 | 5,436 | 3,136 | 1,704 | 1,009 | 1,387 |
| | 100% | 43% | 25% | 13% | 8% | 11% |

## 15 Sensitivity of results to alternative assumptions

### *a Sensitivity analysis – economic assumptions*

The tables below show the sensitivity of the embedded value as at 31 December 2010 (31 December 2009) and the new business contribution after the effect of required capital for 2010 and 2009 to:

- one per cent increase in the discount rates;
- one per cent increase and decrease in interest rates, including all consequential changes (assumed investment returns for all asset classes, market values of fixed interest assets, risk discount rates);
- one per cent rise in equity and property yields;
- 10 per cent fall in market value of equity and property assets (not applicable for new business contribution);
- holding company statutory minimum capital (by contrast to economic capital);
- five basis point increase in long-term expected defaults; and
- 10 basis point increase in the liquidity premium for UK shareholder-backed annuities.

In each sensitivity calculation, all other assumptions remain unchanged except where they are directly affected by the revised economic conditions.

| | **2010 £m** | | | |
|---|---|---|---|---|
| | **Asian operations (including Japan*)** | **US operations** | **UK insurance operations** | **Total long-term business operations** |
| **New business profit for 2010** | | | | |
| As reported[note 10] | **901** | **761** | **365** | **2,027** |
| Discount rates – 1% increase | **(111)** | **(51)** | **(53)** | **(215)** |
| Interest rates – 1% increase | **(7)** | **34** | **(8)** | **19** |
| Interest rates – 1% decrease | **(20)** | **(40)** | **8** | **(52)** |
| Equity/property yields – 1% rise | **41** | **63** | **12** | **116** |
| Long-term expected defaults – 5 bps increase | **-** | **-** | **(13)** | **(13)** |
| Liquidity premium – 10 bps increase | **-** | **-** | **26** | **26** |

*The impact of the sensitivities above for Japan for 2010 is negligible

| | 2009 £m | | | |
|---|---|---|---|---|
| | Asian operations (including Japan) | US operations | UK insurance operations | Total long-term operations |
| **New business profit for 2009** | | | | |
| As reported | 713 | 664 | 230 | 1,607 |
| Discount rates – 1% increase | (91) | (48) | (43) | (182) |
| Interest rates – 1% increase | (3) | 8 | (7) | (2) |
| Interest rates – 1% decrease | 3 | (12) | 8 | (1) |
| Equity/property yields – 1% rise | 31 | 39 | 11 | 81 |
| Long-term expected defaults – 5 bps increase | - | - | (9) | (9) |
| Liquidity premium – 10 bps increase | - | - | 18 | 18 |

| | **2010 £m** | | | |
|---|---|---|---|---|
| | **Asian operations** | **US operations** | **UK insurance operations** | **Total long-term operations** |
| **Embedded value of long-term operations at 31 December 2010** | | | | |
| As reported[note 10] | **7,445** | **4,799** | **5,970** | **18,214** |
| Discount rates – 1% increase | **(643)** | **(164)** | **(437)** | **(1,244)** |
| Interest rates – 1% increase | **(220)** | **(148)** | **(254)** | **(622)** |
| Interest rates – 1% decrease | **176** | **103** | **336** | **615** |
| Equity/property yields – 1% rise | **308** | **120** | **227** | **655** |
| Equity/property market values – 10% fall | **(174)** | **(5)** | **(339)** | **(518)** |
| Statutory minimum capital | **104** | **127** | **5** | **236** |
| Long-term expected defaults – 5 bps increase | **-** | **-** | **(87)** | **(87)** |
| Liquidity premium – 10 bps increase | **-** | **-** | **174** | **174** |

| | 2009 £m | | | |
|---|---|---|---|---|
| | Asian operations | US operations | UK insurance operations | Total long-term operations |
| **Embedded value of long-term operations at 31 December 2009** | | | | |
| As reported[note 10] | 5,781 | 4,122 | 5,439 | 15,342 |
| Discount rates – 1% increase | (522) | (146) | (401) | (1,069) |
| Interest rates – 1% increase | (183) | (137) | (231) | (551) |
| Interest rates – 1% decrease | 231 | 55 | 298 | 584 |
| Equity/property yields – 1% rise | 255 | 82 | 213 | 550 |
| Equity/property market values – 10% fall | (147) | (10) | (298) | (455) |
| Statutory minimum capital | 28 | 123 | 6 | 157 |
| Long-term expected defaults – 5 bps increase | - | - | (76) | (76) |
| Liquidity premium – 10 bps increase | - | - | 152 | 152 |

**b Sensitivity analysis – non-economic assumptions**

The tables below show the sensitivity of the embedded value as at 31 December 2010 (31 December 2009) and the new business contribution after the effect of required capital for 2010 and 2009 to:

- 10 per cent proportionate decrease in maintenance expenses (a 10 per cent sensitivity on a base assumption of £10 per annum would represent an expense assumption of £9 per annum);
- 10 per cent proportionate decrease in lapse rates (a 10 per cent sensitivity on a base assumption of five per cent would represent a lapse rate of 4.5 per cent per annum); and
- five per cent proportionate decrease in base mortality and morbidity rates (i.e. increased longevity).

| | **2010 £m** | | | |
|---|---|---|---|---|
| | **Asian operations (including Japan*)** | **US operations** | **UK insurance operations** | **Total long-term business operations** |
| **New business profit for 2010** | | | | |
| As reported[note 10] | **901** | **761** | **365** | **2,027** |
| Maintenance expenses – 10% decrease | **27** | **9** | **5** | **41** |
| Lapse rates – 10% decrease | **81** | **31** | **8** | **120** |
| Mortality and morbidity – 5% decrease | **50** | **7** | **(20)** | **37** |
| Change representing effect on: | | | | |
| Life business | **50** | **7** | **1** | **58** |
| UK annuities | **-** | **-** | **(21)** | **(21)** |

*The impact of the sensitivities above for Japan for 2010 is negligible

| | 2009 £m | | | |
|---|---|---|---|---|
| | Asian operations (including Japan) | US operations | UK insurance operations | Total long-term business operations |
| **New business profit for 2009** | | | | |
| As reported | 713 | 664 | 230 | 1,607 |
| Maintenance expenses – 10% decrease | 19 | 9 | 8 | 36 |
| Lapse rates – 10% decrease | 56 | 34 | 11 | 101 |
| Mortality and morbidity – 5% decrease | 37 | 7 | (11) | 33 |
| Change representing effect on: | | | | |
| Life business | 37 | 7 | 1 | 45 |
| UK annuities | - | - | (12) | (12) |

| | **2010 £m** | | | |
|---|---|---|---|---|
| | **Asian operations** | **US operations** | **UK insurance operations** | **Total long-term business operations** |
| **Embedded value of long-term operations at 31 December 2010** | | | | |
| As reported[note 10] | **7,445** | **4,799** | **5,970** | **18,214** |
| Maintenance expenses – 10% decrease | **104** | **39** | **48** | **191** |
| Lapse rates – 10% decrease | **293** | **158** | **67** | **518** |
| Mortality and morbidity – 5% decrease | **233** | **81** | **(181)** | **133** |
| Change representing effect on: | | | | |
| Life business | **233** | **81** | **12** | **326** |
| UK annuities | **-** | **-** | **(193)** | **(193)** |

| | 2009 £m | | | |
|---|---|---|---|---|
| | Asian operations | US operations | UK insurance operations | Total long-term business operations |
| **Embedded value of long-term operations at 31 December 2009** | | | | |
| As reported[note 10] | 5,781 | 4,122 | 5,439 | 15,342 |
| Maintenance expenses – 10% decrease | 77 | 33 | 43 | 153 |
| Lapse rates – 10% decrease | 232 | 141 | 70 | 443 |
| Mortality and morbidity – 5% decrease | 169 | 78 | (157) | 90 |
| Change representing effect on: | | | | |
| Life business | 169 | 78 | 11 | 258 |
| UK annuities | - | - | (168) | (168) |

*Effect of proposed change in UK corporation tax rates*
The 2010 results include the impact of the change in UK corporate tax rate that has been enacted to reduce the rate from 28 to 27 per cent from 1 April 2011. The effect of further reductions in the UK corporate tax rate to reduce the rate by one per cent per annum each year from the effective rate of 27 per cent applied in 2010 to 24 per cent in 2014 would increase the net of tax value of the in-force business of UK insurance operations at 1 January 2010 by around £80 million.

## 16 Assumptions

### *(a) Principal economic assumptions*

### *Deterministic assumptions*

The tables below summarise the principal financial assumptions:
Assumed investment returns reflect the expected future returns on the assets held and allocated to the covered business at the valuation date.

Equity risk premiums in Asia range from 3.25 per cent to 8.7 per cent (2009: 3.0 per cent to 8.35 per cent). In the US and the UK, the equity risk premium is 4.0 per cent (2009: 4.0 per cent).

| **Asian operations**[note i] | **31 Dec 2010 %** | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **China** note vi | **Hong Kong** notes iii,v | **India** | **Indonesia** notes iii,vi | **Japan** | **Korea** note vi | **Malaysia** notes iv,v | **Philippines** notes iii,vi | **Singapore** note v | **Taiwan** | **Thailand** | **Vietnam** note vi |
| Risk discount rate: | | | | | | | | | | | | |
| New business | **10.45** | **5.1** | **13.1** | **13.0** | **4.9** | **7.9** | **7.0** | **13.2** | **5.4** | **5.0** | **10.5** | **18.85** |
| In force | **10.45** | **5.1** | **13.1** | **13.0** | **4.9** | **8.1** | **7.1** | **13.2** | **6.1** | **5.2** | **10.5** | **18.85** |
| Expected long-term rate of inflation | **2.5** | **2.25** | **4.0** | **5.0** | **-** | **3.0** | **2.5** | **4.0** | **2.0** | **1.0** | **3.0** | **5.5** |
| Government bond yield | **3.95** | **3.3** | **8.1** | **7.75** | **1.1** | **4.6** | **4.0** | **6.4** | **2.7** | **1.6** | **3.8** | **12.1** |

| | 31 Dec 2009 % | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | China note vi | Hong Kong notes iii,v | India | Indonesia notes iii,vi | Japan | Korea note vi | Malaysia notes iv,v | Philippines notes iii,vi | Singapore note v | Taiwan | Thailand | Vietnam note vi |
| Risk discount rate: | | | | | | | | | | | | |
| New business | 11.75 | 5.5 | 14.25 | 13.8 | 5.1 | 8.2 | 9.1 | 15.75 | 5.7 | 7.5 | 13.0 | 16.75 |
| In force | 11.75 | 5.7 | 14.25 | 13.8 | 5.1 | 8.4 | 9.3 | 15.75 | 6.8 | 7.5 | 13.0 | 16.75 |
| Expected long-term rate of inflation | 4.0 | 2.25 | 5.0 | 6.0 | - | 2.75 | 2.75 | 5.0 | 1.75 | 2.25 | 3.0 | 6.0 |
| Government bond yield | 8.25 | 3.9 | 9.25 | 10.25 | 1.9 | 5.5 | 6.5 | 9.25 | 4.25 | 5.5 | 6.75 | 10.25 |

| | **Asia total %** | |
|---|---|---|
| | **31 Dec 2010** | 31 Dec 2009 |
| Weighted risk discount rate:[note ii] | | |
| New business (excluding Japan) | **8.4** | 9.0 |
| In force | **8.1** | 8.8 |

**Notes**

i In preparing the EEV basis results for 2010 the 'active' basis of economic assumption setting has been applied for all Asian operations. For 2009 the 'active' basis was applied in preparing the EEV results for Japan, Korea and US dollar denominated business written in Hong Kong, as described in note 1(b).

ii The weighted risk discount rates for Asian operations shown above have been determined by weighting each country's risk discount rates by reference to the EEV basis new business result and the closing value of in-force business.

iii The assumptions shown are for US dollar denominated business which comprises the largest proportion of the in-force Hong Kong business. The risk discount rates shown for Indonesia and Philippines are for local currency denominated business which comprises the largest proportion of the in-force business in those territories.

iv The risk discount rate for Malaysia reflects both the Malaysia life and Takaful operations.

v The mean equity return assumptions for the most significant equity holdings in the Asian operations were:

| | **31 Dec 2010 %** | 31 Dec 2009 % |
|---|---|---|
| Hong Kong | **7.3** | 7.9 |
| Malaysia | **10.0** | 12.4 |
| Singapore | **8.7** | 10.2 |

To obtain the mean, an average over all simulations of the accumulated return at the end of the projection period is calculated. The annual average return is then calculated by taking the root of the average accumulated return minus 1.

vi In 2009, the Group reconsidered the application of the Group's methodology for certain less established operations, with a consequent change in the risk discount rates used for Indonesia and Korea and a change in the assumed capital requirement to better align with internal management and pricing bases, primarily in China, Indonesia, Philippines and Vietnam.

| US operations (Jackson) | 31 Dec 2010 % | 31 Dec 2009 % |
|---|---|---|
| Assumed new business spread margins:note iii | | |
| Fixed Annuity business (including the proportion of variable annuity business invested in the general account):note i | | |
| First five years: | | |
| January to June issues | **2.0** | 2.75 |
| July to December issues | **2.0** | 2.25 |
| Long-term assumption | **2.0** | 2.0 |
| Fixed Index Annuity business: | | |
| January to June issues | **2.5** | 3.5 |
| July to December issues | **2.5** | 2.5 |
| | | |
| Risk discount rate: | | |
| Variable annuity | **7.8** | 8.2 |
| Non-variable annuity | **5.6** | 6.2 |
| Weighted average total:note ii | | |
| New business | **7.6** | 7.8 |
| In force | **6.9** | 7.2 |
| US 10-year treasury bond rate at end of period | **3.3** | 3.9 |
| Pre-tax expected long-term nominal rate of return for US equities | **7.3** | 7.9 |
| Expected long-term rate of inflation | **2.3** | 2.4 |

**Notes**

i For new business issuances in 2010, the assumed spread margin for fixed annuities and for the proportion of variable annuity business invested in the general account of 2.0 per cent applies from inception for all durations and reflects the combined effects of net annualised yields on new assets of 4.8 per cent and crediting rates. The spread assumptions for 2009 of 2.75 per cent for January to June issuances and 2.25 per cent for July to December issuances, reflected the exceptional combined benefit of high investment yields which were 6.4 per cent for 2009, and lower crediting rates. The assumptions for 2009 included a provision that crediting rates and spreads would normalise in the future. Therefore, the assumption for new business spreads shown above were set at the higher new level for the first five years before reducing over the following 10 years with the valuation of new business taking into account an assumed associated risk of increased lapse under certain interest rate scenarios.

ii The weighted average risk discount rates reflect the mix of business between variable annuity and non-variable annuity business. The decrease in the weighted average risk discount rates from 2009 to 2010 primarily reflects the decrease in the US 10-year Treasury bond rate of 60 bps, partly offset by a change in the product mix with the 2010 results seeing an increase in the proportion of new and in-force business arising from Variable Annuity business.

iii Credit risk treatment

The projected cash flows incorporate the expected long-term spread between the earned rate and the rate credited to policyholders. The projected earned rates reflect book value yields which are adjusted over time to reflect projected reinvestment rates. Positive net cash flows are assumed to be reinvested in a mix of corporate bonds, commercial mortgages and limited partnerships. The yield on those assets is assumed to grade from the current level to a yield that allows for a long-term assumed credit spread on the reinvested assets of 1.25 per cent over 10 years. The expected new business spread margins are determined after allowing for a Risk Margin Reserve (RMR) allowance for 2010 of 26 bps (2009: 28 bps) for longer-term defaults as described in note 1b(iii). The RMR of 26 bps represents the allowance, as at the valuation applied in the cash flow projections of the value of the in-force business.

In the event that longer-term default levels are higher, then unlike for UK annuity business where policyholder benefits are not changeable, Jackson has some discretion to adjust crediting rates, subject to contract guarantee levels and general market competition considerations.

The results for Jackson reflect the application of the discount rates shown above, which for 2010 and 2009 reflect the inclusion of an additional allowance for a combination of credit risk premium and short-term default allowance as described in note 1b(iii) and note 5.

In the event that US 10-year treasury rates increase, the altered embedded value results would reflect a lower contribution from fixed annuity business and a partially offsetting increase for variable annuity business as the projected earned rate, as well as the discount rate, would increase for this type of business.

| UK insurance operationsnote iv | 31 Dec 2010 % | 31 Dec 2009 % |
|---|---|---|
| **Shareholder-backed annuity business:** | | |
| Risk discount rate:notes i,iv | | |
| New business | **7.3** | 8.7 |
| In force | **9.9** | 10.2 |
| Pre-tax expected long-term nominal rate of return for shareholder-backed annuity business: note iii | | |
| Fixed annuities | **5.1** | 5.6 |
| Inflation-linked annuities | **5.2** | 5.8 |
| **Other business:** | | |
| Risk discount rate:notes ii,iv | | |
| New business | **6.9** | 7.7 |
| In force | **7.0** | 7.4 |
| Pre-tax expected long-term nominal rates of investment return: | | |
| UK equities | **8.0** | 8.4 |
| Overseas equities | **7.3 to 10.2** | 7.9 to 10.3 |
| Property | **6.7** | 6.7 |
| Gilts | **4.0** | 4.4 |
| Corporate bondsnote iv | **5.7** | 6.1 |
| Expected long-term rate of inflation | **3.55** | 3.7 |
| Post-tax expected long-term nominal rate of return for the PAC with-profits fund: | | |
| Pension business (where no tax applies) | **6.7** | 6.9 |
| Life business | **5.9** | 6.0 |

**Notes**

i The risk discount rate applied to shareholder-backed annuity business has been determined after allowing for credit risk as detailed in note iv below.

ii The risk discount rates for new business and business in force for UK insurance operations other than shareholder-backed annuities reflect weighted rates based on the type of business.

iii The pre-tax rates of return for shareholder-backed annuity business are based on the gross redemption yield on the backing assets net of a best estimate allowance for future defaults.

iv Credit spread treatment
For with-profits business, the embedded value reflects the discounted value of future shareholder transfers. These transfers are directly affected by the level of projected rates of return on investments, including debt securities. For 2010 and 2009 results the assumed earned rate for with-profit holdings of corporate bonds is defined as the risk-free rate plus an assessment of the long-term spread over gilts, net of expected long-term defaults. This approach is similar to that applied for equities and properties for which the projected earned rate is defined as the risk-free rate plus a long-term risk premium.

For UK shareholder-backed annuity business, different dynamics apply both in terms of the nature of the business and the EEV methodology applied. For this type of business the assets are generally held to maturity to match long duration liabilities. It is therefore appropriate under EEV methodology to include a liquidity premium in the economic basis used. The appropriate EEV risk discount rate is set in order to equate the EEV with a 'market consistent embedded value' including liquidity premium. The liquidity premium in the 'market consistent embedded value' is derived from the yield on the assets held after deducting an appropriate allowance for credit risk. The risk discount rate in EEV reflects the excess of the total allowance for credit risk over the best estimate default assumptions. For Prudential Retirement Income Limited (PRIL), which has approximately 88 per cent of UK shareholder-backed annuity business, the allowance for credit risk for the in-force business at 31 December 2010 is made up of:

a 16 basis points for fixed annuities and 14 basis points for inflation-linked annuities in respect of long-term expected defaults. This is derived by applying Moody's data from 1970 to 2009 uplifted by between 100 per cent (B) and 200 per cent (AAA) according to credit rating, to the asset portfolios.
b 11 basis points for fixed annuities and 9 basis points for inflation-linked annuities in respect of long-term credit risk premium for the potential volatility in default levels. This is derived by applying the 95th worst percentile from Moody's data from 1970 to 2009, to the asset portfolios.
c 43 basis points for fixed annuities and 39 basis points for inflation-linked annuities in respect of additional short-term credit risk, reflecting short-term credit rating downgrades and defaults in excess of the long-term assumptions. This element of the overall credit assumption has not been derived by reference to credit spreads; rather it has been reduced in order to offset the impact of actual downgrades during the period on the long-term assumptions in (a) and (b) above and increased to eliminate the positive experience variance that would otherwise have arisen from the small number of actual defaults that were experienced in the period. In addition, the assumptions have been updated to reflect changes in the asset mix, arising particularly from the sale of subordinated financial debt and the addition of higher credit quality new business assets (compared to the in-force portfolio).

The credit assumptions used and the residual liquidity premium element of the bond spread over swap rates is as follows:

| **In-force business** | **2010 (bps)** | 2009 (bps) |
|---|---|---|
| Bond spread over swap rates | **160** | 175 |
| Credit risk allowance | | |
| Long-term expected defaults | **16** | 19 |
| Long-term credit risk premium | **10** | 13 |
| Short-term allowance for credit risk | **42** | 39 |
| Total credit risk allowance[2] | **68** | 71 |
| Liquidity premium | **92** | 104 |

| **New business[1]** | **2010 (bps)** | 2009 (bps) |
|---|---|---|
| Bond spread over swap rates | **117** | 198 |
| Total credit risk allowance[2] | **38** | 54 |
| Liquidity premium | **79** | 144 |

**Notes**

1 The new business liquidity premium is based on the weighted average of the point of sale liquidity premium.

2 For 2010 and 2009, specific assets were allocated to the year's new business with the appropriate allowance for credit risk which was 38 basis points (2009: 54 basis points). The reduced allowance for new business in comparison to that for the in-force book reflects the assets held and other factors that influence the necessary level of provision.

The overall allowance for credit risk is prudent by comparison with historic rates of default and would be sufficient to withstand a wide range of extreme credit events over the expected lifetime of the annuity business.

## *Stochastic assumptions*

The economic assumptions used for the stochastic calculations are consistent with those used for the deterministic calculations described above. Assumptions specific to the stochastic calculations, such as the volatilities of asset returns, reflect local market conditions and are based on a combination of actual market data, historic market data and an assessment of longer-term economic conditions. Common principles have been adopted across the Group for the stochastic asset models, for example, separate modelling of individual asset classes but with allowance for correlation between the various asset classes.

Details are given below of the key characteristics and calibrations of each model.

**Asian operations**

- The same asset return models as used in the UK, appropriately calibrated, have been used for the Asian operations as described for UK insurance operations below. The principal asset classes are government and corporate bonds. Equity holdings are much lower than in the UK whilst property holdings do not represent a significant investment asset.
- The stochastic cost of guarantees is primarily only of significance for the Hong Kong, Korea, Malaysia and Singapore operations.
- The mean stochastic returns are consistent with the mean deterministic returns for each country. The expected volatility of equity returns for 2010 and 2009 ranges from 18 per cent to 35 per cent, and the volatility of government bond yields ranges for 2010 from 0.9 per cent to 2.4 per cent (2009: 1.3 per cent to 2.4 per cent).

**US operations (Jackson)**

- Interest rates are projected using a log-normal generator calibrated to the market yield curve at the valuation date;
- Corporate bond returns are based on Treasury securities plus a spread that has been calibrated to current market conditions and varies by credit quality; and
- Variable annuity equity returns and bond interest rates have been stochastically generated using a log-normal model with parameters determined by reference to historical data. The volatility of equity fund returns for 2010 ranges from 19.0 per cent to 32.1 per cent, (2009: 18.6 per cent to 28.1 per cent) depending on the risk class and the class of equity, and the standard deviation of interest rates ranges from 2.0 per cent to 2.4 per cent (2009: 1.4 per cent to 1.6 per cent).

**UK insurance operations**

- Interest rates are projected using a two-factor model calibrated to the initial market yield curve;
- The risk premium on equity assets is assumed to follow a log-normal distribution;
- The corporate bond return is calculated as the return on a zero-coupon bond plus a spread. The spread process is a mean reverting stochastic process; and
- Property returns are modelled in a similar fashion to corporate bonds, namely as the return on a riskless bond, plus a risk premium, plus a process representative of the change in residual values and the change in value of the call option on rents.

Mean returns have been derived as the annualised arithmetic average return across all simulations and durations.

For each projection year, standard deviations have been calculated by taking the square root of the annualised variance of the returns over all the simulations. These have been averaged over all durations in the projection. For equity and property, the standard deviations relate to the total return on these assets. The standard deviations applied are as follows:

| | **2010 %** | 2009 % |
|---|---|---|
| Equities: | | |
| UK | **18.0** | 18.0 |
| Overseas | **18.0** | 18.0 |
| Property | **15.0** | 15.0 |

## *b Demographic assumptions*

Persistency, mortality and morbidity assumptions are based on an analysis of recent experience but also reflect expected future experience. Where relevant, when calculating the time value of financial options and guarantees, policyholder withdrawal rates vary in line with the emerging investment conditions according to management's expectations.

## *c Expense assumptions*

Expense levels, including those of service companies that support the Group's long-term business operations, are based on internal expense analysis investigations and are appropriately allocated to acquisition of new business and renewal of in-force business. Exceptional expenses are identified and reported separately. It is Prudential's policy not to take credit for future cost reduction programmes until the savings have been delivered.

For Asian life operations, the expenses comprise costs borne directly and recharged costs from the Asia Regional Head Office, that are attributable to covered business. The assumed future expenses for these operations also include projections of these future recharges.

Expenditure of the Regional Head Office that is not allocated to the covered business or asset management operations is charged as incurred. These costs are primarily for corporate related activities. Development expenses are also charged as incurred.

Corporate expenditure for Group Head Office, to the extent not allocated to the PAC with-profits funds, together with Solvency II implementation and restructuring costs, are charged to EEV basis results as incurred.

## *d Taxation and other legislation*

Current taxation and other legislation have been assumed to continue unaltered except where changes have been announced and the relevant legislation passed.

# 17 Acquisition of United Overseas Bank Life Assurance Limited

On 1 February 2010, the Group acquired from United Overseas Bank (UOB) its 100 per cent interest in UOB Life Assurance Limited in Singapore for total cash consideration, after post-completion adjustments of SGD67 million (£32 million), of SGD495 million (£220 million). As part of the transaction the Group also entered into a long-term strategic partnership to develop a major regional bancassurance business with UOB.

In addition to the amounts above the Group incurred £2 million of acquisition-related costs (excluding integration costs).

## *Goodwill arising on acquisition*

| | **£m** |
|---|---|
| Cash consideration | **220** |
| Less: fair value of identifiable net assets acquired | **(79)** |
| Goodwill arising on acquisition | **141** |

Goodwill arose on the acquisition of UOB Life Assurance Limited in Singapore because the acquisition included revenue and cost synergies. These synergies could not be recognised as assets separately from goodwill because they are not capable of being separated from the Group and sold, transferred, licensed, rented or exchanged, either individually or together with any related contracts and did not arise from contractual or other legal rights.

None of the goodwill arising on this transaction is expected to be deductible for tax purposes.

## 18 Dilution of holding in PruHealth

On 1 August 2010, Discovery Holdings of South Africa, the Group's joint venture partner in its investment in PruHealth completed the acquisition of the entire share capital of Standard Life Healthcare, a wholly-owned subsidiary of the Standard Life Group, for £138 million. Discovery funded the purchase of the Standard Life Healthcare transaction, and contributed Standard Life Healthcare to PruHealth as a capital investment on completion. As a result of the transaction, Discovery have increased their shareholding in PruHealth from the previous level of 50 per cent to 75 per cent, and Prudential's shareholding has been reduced from 50 per cent of the previous joint venture structure to 25 per cent of the new structure with the much enlarged business.

A gain of £3 million arises upon the dilution, representing the difference between the fair value of the enlarged 25 per cent investment still held and the book value of the original 50 per cent investment holding.

## 19 Sale of the Taiwan agency business in 2009

| | 2009 £m |
|---|---|
| Profit on sale and results for Taiwan agency business | 91 |

In 2009, the Company sold the assets and liabilities of its agency distribution business and its agency force in Taiwan to China Life Insurance Company Ltd of Taiwan for the nominal sum of NT$1. In addition, the Company invested £45 million to purchase a 9.99 per cent stake in China Life through a share placement. The sale was completed on 19 June 2009.

The Company retained its interest in life insurance business in Taiwan through its retained bank distribution partnerships and its direct investment of 9.99 per cent in China Life made in 2009. At 31 December 2010 the Company's interest in China Life was 8.66 per cent.

The profit on sale and results for the period of ownership comprise:

| | £m |
|---|---|
| Proceeds | – |
| Net asset value attributable to equity holders of Company after the effect of completion and other adjustments and provision for restructuring costs | 135 |
| Goodwill written off | (44) |
| | 91 |
| Representing: | |
| Profit arising on sale and result for long-term business operations | 148 |
| Goodwill written off | (44) |
| Adjustments in respect of restructuring costs borne by non-covered business | (13) |
| | 91 |

## 20 Post balance sheet events

In January 2011, the Company issued US$550 million 7.75 per cent Tier 1 subordinated debt, primarily to retail investors. The proceeds, net of costs, were US$539 million and are intended to finance the repayment of the €500 million Tier 2 subordinated notes in December 2011.

## 21 New business premiums and contributions[notes i,ii,iii]

| | Single | | Regular | | Annual premium and contribution equivalents (APE) | | Present value of new business premiums (PVNBP) | |
|---|---|---|---|---|---|---|---|---|
| | **2010** | 2009 | **2010** | 2009 | **2010** | 2009 | **2010** | 2009 |
| | **£m** | £m | **£m** | £m | **£m** | £m | **£m** | £m |
| **Group insurance operations** | | | | | | | | |
| Asia – excl Japan[note iii] | **1,104** | 785 | **1,391** | 1,131 | **1,501** | 1,209 | **7,493** | 5,982 |
| US | **11,417** | 8,885 | **22** | 24 | **1,164** | 912 | **11,572** | 9,048 |
| UK | **5,656** | 4,768 | **254** | 246 | **820** | 723 | **6,842** | 5,902 |
| **Group total – excl Japan** | **18,177** | 14,438 | **1,667** | 1,401 | **3,485** | 2,844 | **25,907** | 20,932 |
| Japan [note iii] | **13** | 57 | **6** | 46 | **7** | 52 | **39** | 263 |
| **Group total** | **18,190** | 14,495 | **1,673** | 1,447 | **3,492** | 2,896 | **25,946** | 21,195 |
| **Asian insurance operations** | | | | | | | | |
| Hong Kong | **107** | 94 | **276** | 232 | **287** | 241 | **1,693** | 1,414 |
| Indonesia | **141** | 41 | **269** | 186 | **283** | 190 | **1,011** | 671 |
| Malaysia | **58** | 63 | **198** | 140 | **204** | 146 | **1,153** | 814 |
| Philippines | **64** | 14 | **17** | 10 | **23** | 11 | **108** | 39 |
| Singapore | **318** | 297 | **143** | 98 | **175** | 128 | **1,357** | 1,033 |
| Thailand | **15** | 14 | **25** | 14 | **26** | 16 | **100** | 54 |
| Vietnam | **1** | 1 | **41** | 35 | **41** | 35 | **148** | 128 |
| ***SE Asian operations inc. Hong Kong*** | **704** | 524 | **969** | 715 | **1,039** | 767 | **5,570** | 4,153 |
| China (Group's 50% interest) | **103** | 72 | **48** | 38 | **58** | 45 | **336** | 253 |
| India (Group's 26% interest) | **85** | 47 | **180** | 163 | **188** | 168 | **582** | 581 |
| Korea | **66** | 38 | **89** | 118 | **96** | 122 | **486** | 568 |
| Taiwan | **146** | 104 | **105** | 97 | **120** | 107 | **519** | 427 |
| **Total Asian operations – excl Japan** | **1,104** | 785 | **1,391** | 1,131 | **1,501** | 1,209 | **7,493** | 5,982 |
| | | | | | | | | |
| **US insurance operations** | | | | | | | | |
| Fixed annuities | **836** | 1,053 | **-** | - | **84** | 105 | **836** | 1,053 |
| Fixed index annuities | **1,089** | 1,433 | **-** | - | **109** | 143 | **1,089** | 1,433 |
| Life | **11** | 10 | **22** | 24 | **23** | 25 | **166** | 173 |
| Variable annuities | **9,481** | 6,389 | **-** | - | **948** | 639 | **9,481** | 6,389 |
| **Total US insurance operations** | **11,417** | 8,885 | **22** | 24 | **1,164** | 912 | **11,572** | 9,048 |
| | | | | | | | | |
| **UK insurance operations** | | | | | | | | |
| Direct and partnership annuities | **593** | 590 | **-** | - | **59** | 59 | **593** | 590 |
| Intermediated annuities | **221** | 242 | **-** | - | **22** | 24 | **221** | 242 |
| Internal vesting annuities | **1,235** | 1,357 | **-** | - | **124** | 136 | **1,235** | 1,357 |
| ***Total individual annuities*** | **2,049** | 2,189 | **-** | - | **205** | 219 | **2,049** | 2,189 |
| Corporate pensions | **228** | 192 | **198** | 191 | **221** | 210 | **1,099** | 1,007 |
| Onshore bonds | **1,660** | 1,444 | **-** | - | **166** | 145 | **1,660** | 1,444 |
| Other products | **774** | 881 | **56** | 55 | **133** | 143 | **1,089** | 1,200 |
| Wholesale[note iv] | **945** | 62 | **-** | - | **95** | 6 | **945** | 62 |
| **Total UK insurance operations** | **5,656** | 4,768 | **254** | 246 | **820** | 723 | **6,842** | 5,902 |
| **Group Total – excl Japan** | **18,177** | 14,438 | **1,667** | 1,401 | **3,485** | 2,844 | **25,907** | 20,932 |

**Notes**

i The tables shown above are provided as an indicative volume measure of transactions undertaken in the reporting period that have the potential to generate profits for shareholders. The amounts shown are not, and not intended to be, reflective of premium income recorded in the IFRS income statement.

Annual Premiums Equivalents (APE) are calculated as the aggregate of regular new business amounts and one-tenth of single new business amounts and are subject to roundings. The Present Value of New Business Premiums (PVNBP) are calculated as equalling single premiums plus the present value of expected premiums of new regular premium business, allowing for lapses and other assumptions made in determining the EEV new business contribution.

New business premiums reflect those premiums attaching to covered business, including premiums for contracts classified as investment products for IFRS basis reporting. New business premiums for regular premium products are shown on an annualised basis. Internal vesting business is classified as new business where the contracts include an open market option.

ii The table above include new business for the Taiwan bank distribution operation. New business of the Taiwan Agency business, which was sold in June 2009, is excluded from the table.

iii New business sales for the Group's Japanese insurance subsidiary, which ceased selling new business with effect from 15 February 2010, have been presented separately from the remainder of the Group.

iv UK wholesale sales for 2010 include amounts for a bulk annuity buy-in insurance agreement with an APE of £88 million.

## RISK FACTORS

A number of factors (risk factors) affect Prudential's operating results and financial condition and, accordingly, the trading price of its shares. The risk factors mentioned below should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties. The information given is as of the date of this report, is not updated, and any forward looking statements are made subject to the reservations specified below under "Forward Looking Statements".

Prudential's approaches to managing risks are explained in the "Business review" section under "Risk and capital management".

### Risks relating to Prudential's business

***Prudential's businesses are inherently subject to market fluctuations and general economic conditions***

Prudential's businesses are inherently subject to market fluctuations and general economic conditions. Uncertain or negative trends in international economic and investment climates could adversely affect Prudential's business and profitability. The adverse effects of volatility arising from such uncertainty and negative trends, including the unprecedented market dislocation across asset classes and geographical markets witnessed in 2008 and in the first half of 2009, have been and would be felt principally through the following:

- investment impairments or reduced investment returns, as a result of market volatility, could impair Prudential's ability to write significant volumes of new business which would have a negative impact on its assets under management and profit;
- higher credit defaults and wider credit and liquidity spreads resulting in realised and unrealised credit losses, as experienced during 2008 and 2009, when illiquidity and credit spreads reached all-time highs;
- Prudential in the normal course of business enters into a variety of transactions with counterparties, including derivative transactions. Failure of any of these counterparties to discharge their obligations, or where adequate collateral is not in place, could have an adverse impact on Prudential's results; and
- estimates of the value of financial instruments are difficult because in certain illiquid or closed markets, determining the value at which financial instruments can be realised is highly subjective. Processes to ascertain value and estimates of value require substantial elements of judgment, assumptions and estimates (which may change over time). Increased illiquidity also adds to uncertainty over the accessibility of financial resources and may reduce capital resources as valuations decline.

During the period of market dislocation in 2008 and the first half of 2009, Prudential had to operate against a challenging background of unprecedented volatility in the global capital and equity markets and interest rates and widespread economic uncertainty. Government interest rates fell to historic lows in the US, global credit spreads widened to historic levels, and credit markets seized up reducing liquidity. These factors had a significant adverse effect on Prudential's business and profitability during that period. Although global markets partially stabilised in 2009 and 2010, interest rates remain low, and many of the challenges of 2008 persist in the credit markets. New challenges may continue to emerge.

For some non-unit-linked investment products, in particular those written in some of the Group's Asian operations, it may not be possible to hold assets which will provide cash flows to match exactly those relating to policyholder liabilities. This is particularly true in those countries where bond markets are not developed and in certain markets where regulated surrender values are set with reference to the interest rate environment prevailing at the time of policy issue. This results in a mismatch due to the duration and uncertainty of the liability cash flows and the lack of sufficient assets of a suitable duration. While this residual asset/liability mismatch risk can be managed, it cannot be eliminated. Where interest rates in these markets remain lower than interest rates used to calculate surrender values over a sustained period, this could have an adverse impact on Prudential's reported profit.

In the US, fluctuations in prevailing interest rates can affect results from Jackson National Life Insurance Company ("Jackson") which has a significant spread-based business, with the majority of its assets invested in fixed income securities. In particular, fixed annuities and stable value products written by Jackson expose Prudential to the risk that changes in interest rates, which are not fully reflected in the interest rates credited to customers, will reduce spread. The spread is the difference between the rate of return Jackson is able to earn on the assets backing the policyholders' liabilities and the amounts that are credited to policyholders in the form of benefit increases, subject to minimum crediting rates.

Declines in spread from these products or other spread businesses that Jackson conducts could have a material impact on its businesses or results of operations. Jackson also writes a significant amount of variable annuities that offer capital or income protection guarantees. There could be unforeseen market circumstances where the derivatives that it enters into to hedge its market risks may not fully offset its losses, and any cost of the guarantees that remain unhedged will also affect Prudential's results.

A significant part of the profit from Prudential's UK insurance operations is related to bonuses for policyholders declared on with-profits products, which are broadly based on historical and current rates of return on equity, real estate and fixed income securities, as well as Prudential's expectations of future investment returns.

***Prudential is subject to the risk of potential sovereign debt credit deterioration owing to the amounts of sovereign debt obligations held in its investment portfolio***

Prudential is subject to the risk of potential sovereign debt credit deterioration and default. Investment in sovereign debt obligations involves risks not present in debt obligations of corporate issuers. Investing in such instruments creates exposure to the direct or indirect consequences of political, social or economic changes (including changes in governments, heads of states or monarchs) in the countries in which the issuers are located and the creditworthiness of the sovereign. In addition, the issuer of the debt or the governmental authorities that control the repayment of the debt may be unable or unwilling to repay principal or pay interest when due in accordance with the terms of such debt, and Prudential may have limited recourse to compel payment in the event of a default. A sovereign debtor's willingness or ability to repay principal and to pay interest in a timely manner may be affected by, among other factors, its cash flow situation, its relations with its central bank, the extent of its foreign currency reserves, the availability of sufficient foreign exchange on the date a payment is due, the relative size of the debt service burden to the economy as a whole, the sovereign debtor's policy toward local and international lenders, and the political constraints to which the sovereign debtor may be subject. Periods of economic uncertainty may affect the volatility of market prices of sovereign debt to a greater extent than the volatility inherent in debt obligations of other types of issues. If a sovereign were to default on its obligations, this could have a material adverse effect on Prudential's financial condition and results of operations.

***Prudential is subject to the risk of exchange rate fluctuations owing to the geographical diversity of its businesses***

Due to their geographical diversity, Prudential's businesses are subject to the risk of exchange rate fluctuations. Prudential's operations in the US and Asia, which represent a significant proportion of operating profit and shareholders' funds, generally write policies and invest in assets denominated in local currency. Although this practice limits the effect of exchange rate fluctuations on local operating results, it can lead to significant fluctuations in Prudential's consolidated financial statements upon translation of results into pounds sterling. The currency exposure relating to the translation of reported earnings is not currently separately managed. The impact of gains or losses on currency translations is recorded as a component of shareholders' funds within other comprehensive income. Consequently, this could impact on Prudential's gearing ratios (defined as debt over debt plus shareholders' funds).

***Prudential conducts its businesses subject to regulation and associated regulatory risks, including the effects of changes in the laws, regulations, policies and interpretations and any accounting standards in the markets in which it operates***

Changes in government policy, legislation (including tax) or regulatory interpretation applying to companies in the financial services and insurance industries in any of the markets in which Prudential operates, which in some circumstances may be applied retrospectively, may adversely affect Prudential's product range, distribution channels, capital requirements and, consequently, reported results and financing requirements. Also, regulators in jurisdictions in which Prudential operates may change the level of capital required to be held by individual businesses or could introduce possible changes in the regulatory framework for pension arrangements and policies, the regulation of selling practices and solvency requirements. Furthermore, as a result of the recent interventions by governments in response to global economic conditions, it is widely expected that there will be a substantial increase in government regulation and supervision of the financial services industry, including the possibility of higher capital requirements, restrictions on certain types of transaction structure, and enhanced supervisory powers.

Current EU directives, including the EU Insurance Groups Directive ("IGD") require European financial services groups to demonstrate net aggregate surplus capital in excess of solvency requirements at the group level in respect of shareholder-owned entities. The test is a continuous requirement, so that Prudential needs to maintain a somewhat higher amount of regulatory capital at the group level than otherwise necessary in respect of some of its individual businesses to accommodate, for example, short-term movements in global foreign exchange rates, interest rates, deterioration in credit quality and equity markets. The EU is also developing a new solvency framework for insurance companies, referred to as "Solvency II". The new approach will be based on the concept of three pillars — minimum capital requirements, supervisory review of firms' assessment of risk, and enhanced disclosure requirements — and will cover valuations, the treatment of insurance groups, the definition of capital and the overall level of capital requirements. A key aspect of Solvency II is that the assessment of risks and capital requirements will be aligned more closely with economic capital methodologies, and may allow Prudential to make use of its internal economic capital models, if approved by the Financial Services Authority (FSA) or other relevant supervisory authority. The Solvency II Directive was formally approved by a meeting of the EU's Economic and Financial Affairs Council on 10 November 2009. The European Commission is in the process of consulting on the detailed rules that will complement the high-level Principles of the Directive, referred to as "implementing measures", which are not expected to be finalised until late 2011. There is a significant uncertainty regarding the final outcome of this process. As a result there is a risk that the effect of the measures finally adopted could be adverse for Prudential, including potentially a significant increase in capital required to support its business.

Various jurisdictions in which Prudential operates have created investor compensation schemes that require mandatory contributions from market participants in some instances in the event of a failure of a market participant. As a major participant in the majority of its chosen markets, circumstances could arise where Prudential, along with other companies, may be required to make such contributions.

The Group's accounts are prepared in accordance with current International Financial Reporting Standards ("IFRS") applicable to the insurance industry. The International Accounting Standards Board ("IASB") introduced a framework that it described as Phase I, which permitted insurers to continue to use the statutory basis of accounting for insurance assets and liabilities that existed in their jurisdictions prior to January 2005.. In July 2010, the IASB has published an Exposure Draft for its Phase II on insurance accounting, which would introduce significant changes to the statutory reporting of insurance entities that prepare accounts according to IFRS. The IASB has indicated a target date of June 2011 for issuing a final standard but it remains uncertain whether and how the proposals in the Exposure Draft will become definitive IFRS and when such changes might take effect.

Any changes or modification of IFRS accounting policies may require a change in the future results or a restatement of reported results.

European Embedded Value ("EEV") basis results are published as supplementary information by Prudential using principles issued by the European CFO (Chief Financial Officers) Forum. The EEV basis is a value-based reporting method for Prudential's long-term business which is used by market analysts and which underpins a significant part of the key performance indicators used by Prudential's management for both internal and external reporting purposes. In June 2008, in an effort to improve the consistency and transparency of embedded value reporting, the CFO Forum published the Market Consistent Embedded Value (MCEV) Principles. Following a review of the impact of turbulent market conditions on the MCEV Principles, the CFO Forum announced in May 2009 the postponement of the mandatory reporting on an MCEV basis and subsequently, in October 2009, changes in the principles to allow for the inclusion of a liquidity premium, which is the additional return investors require for investing in less liquid assets and is a key component in the calculation of the profitability of UK annuity business. It also announced that it was performing further work to develop more detailed application guidance to increase consistency going forward. When the work has been completed, Prudential will consider its approach to the new Principles. The adoption of the new Principles would give rise to different embedded value results from those prepared under the application of European Embedded Value Principles.

***The resolution of several issues affecting the financial services industry could have a negative impact on Prudential's reported results or on its relations with current and potential customers***

Prudential is, and in the future may be, subject to legal and regulatory actions in the ordinary course of its business, both in the UK and internationally. These actions could involve a review of business sold in the past under acceptable market practices at the time, such as the requirement in the UK to provide redress to certain past purchasers of pension and mortgage endowment policies, changes to the tax regime affecting products and regulatory reviews on products sold and industry practices, including, in the latter case, businesses it has closed.

Regulators particularly, but not exclusively, in the US and the UK are moving towards a regime based on principles-based regulation which brings an element of uncertainty. These regulators are increasingly interested in the approach that product providers use to select third party distributors and to monitor the appropriateness of sales made by them. In some cases, product providers can be held responsible for the deficiencies of third-party distributors.

In the US, federal and state regulators have focused on, and continue to devote substantial attention to, the mutual fund, fixed index annuity and insurance product industries. This focus includes new regulations in respect of the suitability of sales of certain products. As a result of publicity relating to widespread perceptions of industry abuses, there have been numerous regulatory inquiries and proposals for legislative and regulatory reforms.

In Asia, regulatory regimes are developing at different speeds, driven by a combination of global factors and local considerations. There is a risk that new requirements are introduced that challenge current practices, or are retrospectively applied to sales made prior to their introduction.

***Litigation, disputes and regulatory investigations may adversely affect Prudential's profitability and financial condition***

Prudential is, and may be in the future, subject to legal actions, disputes and regulatory investigations in the ordinary course of its insurance, investment management and other business operations. These legal actions, disputes and investigations may relate to aspects of Prudential's businesses and operations that are specific to Prudential, or that are common to companies that operate in Prudential's markets. Legal actions and disputes may arise under contracts, regulations (including tax) or from a course of conduct taken by Prudential, and may be class actions. Although Prudential believes that it has adequately provided in all material aspects for the costs of litigation and regulatory matters, no assurance can be provided that such provisions are sufficient. Given the large or indeterminate amounts of damages sometimes sought, and the inherent unpredictability of litigation and disputes, it is possible that an adverse outcome could, from time to time, have an adverse effect on Prudential's results of operations or cash flows.

***Prudential's businesses are conducted in highly competitive environments with developing demographic trends and continued profitability depends on management's ability to respond to these pressures and trends***

The markets for financial services in the UK, US and Asia are highly competitive, with several factors affecting Prudential's ability to sell its products and continued profitability, including price and yields offered, financial strength and ratings, range of product lines and product quality, brand strength and name recognition, investment management performance, historical bonus levels, developing demographic trends and customer appetite for certain savings products. In some of its markets, Prudential faces competitors that are larger, have greater financial resources or a greater market share, offer a broader range of products or have higher bonus rates or claims-paying ratios. Further, heightened competition for talented and skilled employees and agents with local experience, particularly in Asia, may limit Prudential's potential to grow its business as quickly as planned.

In Asia, the Group's principal regional competitors are international financial companies, including Allianz, AXA, ING, AIA and Manulife. In a number of markets, local companies have a very significant market presence.

Within the UK, Prudential's principal competitors in the life market include many of the major retail financial services companies including, in particular, Aviva, Legal & General, Lloyds Banking Group and Standard Life.

Jackson's competitors in the US include major stock and mutual insurance companies, mutual fund organisations, banks and other financial services companies such as AIG, AXA Financial Inc., Hartford Life Inc., Lincoln National, MetLife and TIAA-CREF.

Prudential believes competition will intensify across all regions in response to consumer demand, technological advances, the impact of consolidation, regulatory actions and other factors. Prudential's ability to generate an appropriate return depends significantly upon its capacity to anticipate and respond appropriately to these competitive pressures.

***Downgrades in Prudential's financial strength and credit ratings could significantly impact its competitive position and hurt its relationships with creditors or trading counterparties***

Prudential's financial strength and credit ratings, which are used by the market to measure its ability to meet policyholder obligations, are an important factor affecting public confidence in most of Prudential's products, and as a result its competitiveness. Downgrades in Prudential's ratings, as a result of, for example, decreased profitability, increased costs, increased indebtedness or other concerns, could have an adverse effect on its ability to market products and retain current policyholders. In addition, the interest rates Prudential pays on its borrowings are affected by its debt credit ratings, which are in place to measure the Group's ability to meet its contractual obligations.

Prudential's long-term senior debt is rated as A2 (negative outlook) by Moody's, A+ by Standard & Poor's and A by Fitch;

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

The Prudential Assurance Company Limited long-term fund is rated Aa2 (negative outlook) by Moody's, AA by Standard & Poor's and AA by Fitch;

Jackson's financial strength is rated AA by Standard & Poor's and Fitch, A1 (negative outlook) by Moody's, and A+ by AM Best.

In addition, changes in methodologies and criteria used by rating agencies could result in downgrades that do not reflect changes in the general economic conditions or Prudential's financial condition.

***Adverse experience in the operational risks inherent in Prudential's business could have a negative impact on its results of operations***

Operational risks are present in all of Prudential's businesses, including the risk of direct or indirect loss resulting from inadequate or failed internal and external processes, systems and human error or from external events. Prudential's business is dependent on processing a large number of complex transactions across numerous and diverse products, and is subject to a number of different legal and regulatory regimes. In addition, Prudential outsources several operations, including a significant part of its UK back office and customer-facing functions as well as a number of IT functions, resulting in reliance upon the operational processing performance of its outsourcing partners.

Further, because of the long-term nature of much of the Group's business, accurate records have to be maintained for significant periods. Prudential's systems and processes incorporate controls which are designed to manage and mitigate the operational risks associated with its activities. For example, any weakness in the administration systems or actuarial reserving processes could have an impact on its results of operations during the effective period. Prudential has not experienced or identified any operational risks in its systems or processes during 2010, which have subsequently caused, or are expected to cause, a significant negative impact on its results of operations.

***Adverse experience against the assumptions used in pricing products and reporting business results could significantly affect Prudential's results of operations***

Prudential needs to make assumptions about a number of factors in determining the pricing of its products and setting reserves and for reporting its capital levels and the results of its long-term business operations. For example, the assumption that Prudential makes about future expected levels of mortality is particularly relevant for its UK annuity business. In exchange for a premium equal to the capital value of their accumulated pension fund, pension annuity policyholders receive a guaranteed payment, usually monthly, for as long as they are alive. Prudential conducts rigorous research into longevity risk, using data from its substantial annuitant portfolio. As part of its pension annuity pricing and reserving policy, Prudential's UK business assumes that current rates of mortality continuously improve over time at levels based on adjusted data from the Continuous Mortality Investigations (CMI) as published by the Institute and Faculty of Actuaries. If mortality improvement rates significantly exceed the improvement assumed, Prudential's results of operations could be adversely affected.

A further example is the assumption that Prudential makes about future expected levels of the rates of early termination of products by its customers (persistency). This is particularly relevant to its lines of business other than its UK annuity business. Prudential's persistency assumptions reflect recent past experience for each relevant line of business. Any expected deterioration in future persistency is also reflected in the assumption. If actual levels of future persistency are significantly lower than assumed (that is, policy termination rates are significantly higher than assumed), the Group's results of operations could be adversely affected.

Another example is the impact of epidemics and other effects that cause a large number of deaths. Significant influenza epidemics have occurred three times in the last century, but the likelihood, timing, or the severity of future epidemics cannot be predicted. The effectiveness of external parties, including governmental and non-governmental organisations, in combating the spread and severity of any epidemics could have a material impact on the Group's loss experience.

In common with other industry participants, the profitability of the Group's businesses depends on a mix of factors including mortality and morbidity trends, policy surrender rates, investment performance and impairments, unit cost of administration and new business acquisition expense.

***As a holding company, Prudential is dependent upon its subsidiaries to cover operating expenses and dividend payments.***

The Group's insurance and investment management operations are generally conducted through direct and indirect subsidiaries.

As a holding company, Prudential's principal sources of funds are remittances from subsidiaries, shareholder-backed funds, the shareholder transfer from long-term funds and any amounts that may be raised through the issuance of equity, debt and commercial paper. Certain of the subsidiaries are restricted by applicable insurance, foreign exchange and tax laws, rules and regulations that can limit the payment of dividends, which in some circumstances could limit the ability to pay dividends to shareholders or to make available funds held in certain subsidiaries to cover operating expenses of other members of the Group.

***Prudential operates in a number of markets through joint ventures and other arrangements with third parties (including in China and India), involving certain risks that Prudential does not face with respect to its consolidated subsidiaries***

Prudential operates, and in certain markets is required by local regulation to operate, through joint ventures (including in China and India). For the Group's joint venture operations, management control is exercised jointly with the venture participants. The level of control exercisable by the Group depends on the terms of the joint venture agreements, in particular, the allocation of control among, and continued co-operation between, the joint venture participants. Prudential may also face financial or other exposure in the event that any of its joint venture partners fails to meet its obligations under the joint venture or encounters financial difficulty. In addition, a significant proportion of the Group's product distribution is carried out through arrangements with third parties not controlled by Prudential and is dependent upon continuation of these relationships. A temporary or permanent disruption to these distribution arrangements could adversely affect the results of operations of Prudential.

***Prudential's Articles of Association contain an exclusive jurisdiction provision***

Under Prudential's Articles of Association, certain legal proceedings may only be brought in the courts of England and Wales. This applies to legal proceedings by a shareholder (in its capacity as such) against Prudential and/or its directors and/or its professional service providers. It also applies to legal proceedings between Prudential and its directors and/or Prudential and Prudential's professional service providers that arise in connection with legal proceedings between the shareholder and such professional service provider. This provision could make it difficult for US and other non-UK shareholders to enforce their shareholder rights.

***Changes in tax legislation may result in adverse tax consequences***

Tax rules, including those relating to the insurance industry, and their interpretation, may change, possibly with retrospective effect, in any of the jurisdictions in which Prudential operates. Significant tax disputes with tax authorities, and any change in the tax status of any member of the Group or in taxation legislation or its interpretation could affect Prudential's profitability and ability to provide returns to shareholders or alter the post-tax returns to shareholders.

By order of the Board
**Prudential plc**
**Margaret Ann Coltman**
*Company Secretary*

9 March 2011, London

As at the date of this announcement, the board of directors of Prudential plc comprises:

*Executive Directors*
Cheick Tidjane Thiam *(Group Chief Executive)*
Nicolaos Andreas Nicandrou ACA
Robert Alan Devey
John William Foley
Michael George Alexander McLintock
Barry Lee Stowe
Michael Andrew Wells

*Independent Non-executive Directors*
Harvey Andrew McGrath *(Chairman)*
Keki Bomi Dadiseth FCA
Howard John Davies
Michael William Oliver Garrett
Ann Frances Godbehere FCGA
Bridget Ann Macaskill
Paul Victor Falzon Sant Manduca
Kathleen Anne O'Donovan ACA
James Hood Ross
Lord Andrew Turnbull KCB CVO